British Columbia Telephone Company Annual Report 1986

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Two technologies which are transforming communications — high capacity, hair-fine light guides (optical fibres) and complex micro processor chips — provide the basis for the cover design.

Other photographs throughout the Report show some of the people of the B.C. Tel Group applying these and other leading edge technologies to provide Quality service with pride.

Comparative Highlights

For The Years Ended December 31

		1986	1985	Increase (Decrease)
Revenues, Expenses And Earnings *($ Millions)*	Telecommunications operations			
	– revenues	**$1,308.0**	$1,217.0	7.5%
	– expenses	**$ 922.3**	$ 876.0	5.3%
	Manufacturing operations			
	– sales	**$ 170.7**	$ 167.5	1.9%
	– costs and expenses	**$ 166.4**	$ 167.2	(.5%)
	Combined operating earnings	**$ 390.0**	$ 341.3	14.3%
	Ordinary share earnings	**$ 113.9**	$ 97.5	16.8%
Ordinary Shareholders' Items				
	Average shares outstanding *(Thousands)*	**46,263**	44,204	4.7%
	Earnings per share	**$ 2.46**	$ 2.21	11.3%
	Dividends declared per share	**$ 1.72**	$ 1.72	—%
	Equity per share	**$ 20.21**	$ 18.95	6.6%
	Return on average ordinary share equity	**12.65%**	12.01%	5.3%
Invested Capital				
	Average invested capital *($ Millions)*	**$2,285.9**	$2,203.7	3.7%
	Return on average invested capital	**11.24%**	10.86%	3.5%
Other Statistics				
	Gross capital expenditures *($ Millions)*	**$ 360.9**	$ 368.5	(2.1%)
	Internally generated cash from operations *($ Millions)*	**$ 305.5**	$ 302.3	1.1%
	Percent of expenditures internally generated	**85%**	82%	3.7%
	Customer access lines in service	**1,579,245**	1,525,150	3.5%
	Customer access line gain for the year	**54,095**	50,349	7.4%
	Long distance calls completed *(Millions)*	**207.1**	192.2	7.8%
	Regular full time employees at year end	**15,585**	15,863	(1.8%)

The Chairman's Letter

The application of advanced technology and the increased effectiveness of our employees enabled your Company to take advantage of the gradual strengthening of the provincial economy which was aided by Expo 86. As a result, we were able to post reasonably reassuring financial results.

While these results are still not at the level which we consider to be appropriate for this Company, they are encouraging and validate the major long-term management and investment decisions which were made during the past decade.

It has taken time and intensive effort — to say nothing of very, very large investments of capital to transform our Company into the diversified, customer-responsive, marketing-oriented business it is today.

We have reorganized our Company and its diversified components in the B.C. Tel Group. We have put in place or upgraded a physical plant containing the best of the advanced technologies of our industry, including products of our own research and development resource. We have carried out extensive training and retraining programs.

We have devised and implemented effective marketing strategies and techniques and have selected popular and profitable products and services for our marketing thrusts.

We are creating and adopting a new corporate culture which challenges every one of us to strive for excellence and which fosters the spirit of responsible competition.

This continuing multi-faceted approach is our response to the challenge of the fundamental changes being wrought in our society by the impact of information technology.

Technological innovation, which is fueled by research and development, is the key to improving the productivity of any entity — a company, a province or a nation — and thereby improving its competitive ability. The importance of research and development in an industry such as ours cannot be overstated.

One of the conditions I attached to our acquisition of manufacturing capability in 1979 was that there must be a complementary research and development facility. We created Microtel Pacific Research for that purpose.

In addition to the substantial investments we continue to make in our own research and development resource, we have attempted to improve the position of R&D generally by urging the federal and provincial levels of government to recognize its vital importance to a healthy, competitive economy. The amount of support a single corporation can supply is limited.

Obviously, we must ensure that our own facility is performing its primary function — to be of benefit to the corporation as a whole. To that end we are re-emphasizing the potential synergistic benefits our own R&D resource can provide and ensuring that the importance of this function is understood and endorsed throughout the B.C. Tel Group.

The extent to which we are introducing and employing advanced technology can be illustrated by an example from the core of our business — Telephone Operations. B.C. Tel now has a higher percentage of its lines served by electronic switching than any other investor-owned telephone company in Canada. The gain in 1986 was most impressive — from some 70% of our lines in 1985 to 87% by the end of 1986.

This utilization of the latest technology has far more significance than providing pride of place for our Company. It means that we are able to apply technology to help contain operating costs and at the same time expand the quality and

variety of the profitable services and products we offer our customers.

Technology also provides assets which do not appear on our balance sheet but which are of tremendous value to the Company and, ultimately, to our shareholders and customers.

These assets are the information technology applications — the hundreds of software systems such as those used for our regional network control centres, facilities management, customer billing or the new automatic audio intercept response system for directory assistance. A conservative estimate of the replacement value of these software systems is well over a billion dollars. Their day-to-day value is the provision of greatly increased intra-company efficiency and, in many instances, a competitive edge.

However, an aggregate of technology is, of itself, no guarantee of successful operations or profitable performance. To achieve these results, appropriate technology must be selected; it must be applied effectively and used efficiently. That is the responsibility of the employees of the B.C. Tel Group at all levels and it is a responsibility they carried out superbly in 1986, notably in connection with Expo 86.

Whatever the long-term economic benefits of Expo 86 for the economy of British Columbia, its on-site success demonstrated convincingly that the employees of the B.C. Tel Group can and do operate at the world-class level.

Responsibilities included meticulous planning and execution in supplying the major telecommunications requirements of the exposition and the day-to-day monitoring of its services and installations as well as a significant contribution to the success of the Telecom Canada Pavilion. In total, the B.C. Tel Group emerged from the Expo experience with new pride of accomplishment, new awareness of its own potential and a firmer bonding of its team spirit.

Expo 86 was the most visible evidence of the qualities our employees bring to every assignment and challenge but it was by no means the only example. Many of the Group's resources were engaged in meeting the extraordinary demands of Expo 86. In spite of these demands, the Company continued to meet its other objectives including an improved level of service to our customers.

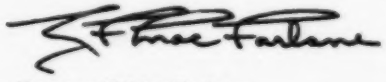
The effective performance of our employees is based on knowledgable and efficient use of the tools, equipment, strategies and techniques which make up our corporate resources. The motivation that transforms 'adequate' to 'excellent' rests on the growing endorsation of our changing corporate culture and the job enrichment made possible by diversification and market orientation.

The advanced technologies we have put in place enable our employees to offer better and more varied services to our customers. Positive customer reaction to these improvements reinforces the pride and enthusiasm of the employees who, in turn, try to achieve even higher levels of customer satisfaction and ultimately higher levels of profitability.

That was the story across the spectrum of the B.C. Tel Group in 1986. A process of continuing refinement of existing practices and a constant search for new or broader avenues leading to increased profitability characterized the attitudes and activities of each member of the B.C. Tel Group in both the utility and entrepreneurial segments of our corporation.

The result was a year of significant accomplishment — a year in which we moved closer to our goal of Excellence — a year which saw us getting it all together for our owners, our customers, our people and the future.

I wish to thank my fellow officers and members of the Board of Directors for the support, guidance and direction they provided throughout the year and to recognize the outstanding contributions of our people in every segment of the B.C. Tel Group.



Gordon F. MacFarlane
Chairman and
Chief Executive Officer

The new GTD-5 EAX switch in North Vancouver went into service on September 21, 1986 to provide better service for the 50,000 customer lines served by this central office. With cooperation from Microtel's manufacturing facility in Brockville, Ontario, crews from B.C. Tel — Telephone Operations and Canadian Telephone & Supplies were able to install the switch in a record breaking time of nine months compared with the twelve to fifteen month period normally required.

Report Of Directors

Getting It All Together ... For Our Owners

The financial statements and notes of the Financial Report provide shareholders with a 'snapshot' of the Company's financial position as of the year end.

In past years, the directors' reports have attempted to sketch in the background to this picture with descriptions of the activities of each section of each unit in the B.C. Tel Group.

This year, the Report of Directors is a sampling of some of these activities — examples which give shareholders sharply focused pictures which are representative of the energy, initiative and team spirit displayed by our employees in every segment of the B.C. Tel Group.

By far the largest member of the Group in terms of assets, revenue generation and number of employees is Telephone Operations, centred on our ubiquitous, high technology, high performance network. Microtel Limited, with its focus on leading edge technology, is rebuilding itself into an international equipment supplier meeting the needs of world-wide network providers as well as those of B.C. Tel. In addition, Microtel supports the research and development needs of the B.C. Tel Group through its Microtel Pacific Research subsidiary. On the entrepreneurial side are Business Telecom Equipment, B.C. Cellular, the Portable Communications Division, Telecommunication Services International and Telecom Leasing Canada as well as the marketing elements of Telephone Operations, Microtel and Canadian Telephones and Supplies.

This diversification of resources, talent and skills gives B.C. Tel the stability and the scope to meet the many and varied challenges and opportunities facing the telecommunications industry.

In 1986, we met many of those challenges and seized many of those opportunities as we succeeded in getting it all together for the benefit of our owners, our customers and our people.

Financial Performance

While all the activities of all members of the B.C. Tel Group ultimately affect the financial performance of the Company, those directly associated with increasing revenues, improving efficiency and containing costs have an obvious direct impact on the bottom line.

The fact that the 1986 earnings per share — $2.46 — were the highest ever achieved by the Company, in spite of having 4.7% more average ordinary shares outstanding than in 1985, is an indication of the effectiveness of these activities.

Investor approbation of the Company's performance may be judged by the reception of the share offering in the third quarter of the year when nearly three million ordinary shares were issued at 147% of book value, the highest ever achieved by the Company. Records were also set for participation in the Dividend Reinvestment and Share Purchase Plan and the Employee Share Purchase Plan.

More precise indicators show a general improvement in the Company's financial picture over that of 1985.

— the total ordinary equity in the capital structure increased from 38% to 41%

— interest coverage improved from 2.9 times to 3.3 times

— the equity per ordinary share increased by 6.6%.

Other results are discussed in the Financial Review.

That these results could be achieved in a gradually strengthening provincial economy testifies to Group-wide efforts to bring in new or increased revenues; to keep the costs of doing business as low as possible consistent with our standards of high quality and to operate all our businesses efficiently.

Generating Revenues

In 1986, total revenues and sales for the members of the B.C. Tel Group amounted to $1,478.7 million, compared with $1,384.5 million in 1985.

Telephone operations accounted for some $1,308.0 million from its regulated and competitive activities including local and long distance telephone services, transmission of data and facsimile, and other telecommunications services and

A mass of information is required each month to enable senior accounting staff to prepare month-end financial reports.

sales. This compares with $1,217.0 million in 1985.

Manufacturing operations produced some $170.7 million from telecommunications equipment manufacturing which includes research and development, and sales of telecommunications equipment, training, engineering, distributed products, installations services and sub-contract manufacturing for a variety of major companies. This compares with a figure of $167.5 million for 1985.

The increase of some $94.2 million in revenues and sales for 1986 by the B.C. Tel Group can be attributed, in part, to the effect of Expo 86 and to the gradual improvement in the economy. However, a large portion of the increase was produced by the energy, initiative and refined marketing techniques of the people of the B.C. Tel Group working in coordination.

A sampling of these initiatives and coordinated efforts demonstrates how our human resources were using our advanced technology in 'getting it all together' to increase revenues.

'Customnets'

B.C. Tel has been working with fellow members of Telecom Canada to develop special network applications using iNet to meet the specific needs of companies or common-interest groups. To date, business is coming from Cbanet for the Canadian legal community; Infohealth for health care professionals; Ctanet for trucking interests and Thornet for Thorne, Ernst and Whinney's finance and accounting interests. Thornet was developed jointly by the customer and B.C. Tel and required customized network design, special ordering and billing procedures and extensive related developmental activity.

Competitive Strategy

In the increasingly competitive world of information technology, a shifting regulatory climate, consumer desire for alternatives, new products and other factors indicate more competition for the Company.

We must maintain and strengthen our position in the marketplace and earn and keep the support of our customers. We must also take every opportunity to stimulate new markets.

To implement this strategy within Telephone Operations, the network marketing department was reorganized in 1986 to place new emphasis on better serving our customers' needs and wants.

Planning, support and implementation of marketing activities are tailored to customer groups such as large business and government, medium business and consumers. One of the specific initiatives is the provision of a single point of contact for all enquiries from customers on service, products or policy.

Through the team action approach and more sophisticated targeting of potential business, network marketing intends to make increased competition work for — not against — the Company's best interests.

Pushing The Basics

The provision of data transmission facilities is an important part of B.C. Tel's revenue generation. In 1986, Datapac service was extended to seven more cities in British Columbia and now serves fifteen centres in the province. Datapac revenues are growing at a rate of 40-50% per year.

Dataroute, which provides dedicated full duplex data service, expanded into five new serving areas in British Columbia and connects some 80 designated major Canadian cities.

'Sell One More'

A sales-referral program for all B.C. Tel employees began as a pilot project in Campbell River and received such enthusiastic employee response and good results that it is being phased in Company-wide. During the trial period over 80% of the referrals resulted in the sale of one or more services.

'Invite The World'

Network marketing promotes the sales of its services and products at the consumer level through a variety of special programs. One of the most successful in 1986 was the 'Invite the World' long distance contest carried out in connection with Expo 86. The contest drew over 130,000 entries and generated almost half a million dollars in revenues.

This user-friendly terminal provides economical access to a nation-wide digital data network — Datapac — on a pay-as-you-use basis.

Business Telecom Equipment (BTE)
With more than 22,000 business clients and a commanding share of the market, BTE has positioned itself as the industry leader in data and voice communication products. BTE added integrated office systems and consulting services to its portfolio of competitive business ventures in 1986.

BTE has entered into a co-operative working relationship with North America's largest supplier of networked computer systems — Digital Equipment — to provide integrated office systems which will link individuals, departments and branches of a business into one productive unit. BTE's expertise in consulting, planning, analysis, training and project management during implementation complements the computers and office productivity systems of Digital Equipment to produce a powerful entry in this competitive field.

Telecom Leasing Canada (TLC)
TLC — formerly Cantel Leasing Ltd. — has as its focus the provision of financing to support sales by members of the B.C. Tel Group. In three years, their lease portfolio has grown from $9 million to some $50 million in 1986. TLC is capitalizing on its growing base of customers by providing financing on virtually all capital assets including those sold by non-affiliates, thereby producing new and increased revenues.

Government Contracts — Microtel
Microtel has targeted the federal government as a major market opportunity for its products and services. The first success story in this new market was the $268 million North Warning System contract. A dedicated team in Ottawa is pursuing further contracts. In addition, Microtel Pacific Research markets its particular expertise and has been very successful in obtaining contracts for technology development and systems planning for the federal government and Telecom Canada.

Spacetel Sells
Microtel's Spacetel line of advanced digital satellite communications systems continues to sell on national and international markets. Among the major contracts obtained in 1986 were orders from Alberta Government Telephones, Telesat and the Thailand police department. Initial sales of Spacetel were realized in the U.S., a market that Microtel has just begun serving from an Atlanta, Georgia base.

Containing Costs

Total operating expenses for the B.C. Tel Group amounted to $1,088.7 million, an increase of 4.4% over the $1,043.2 million in 1985.

The continuing program of restraint practised throughout the Group in 1986 was responsible for much of the cost containment, as was the reduction in the work force. Attrition and early retirement incentive programs enabled the Company to reduce its employee count without resorting to layoffs.

Apart from these major Group-wide cost containment initiatives and programs, each member of the B.C. Tel Group put its own cost-saving measures into effect in 1986.

Doing It Ourselves
In instance after instance, people of the B.C. Tel Group have effected savings by doing a great deal of replacement and repair work 'in-house'. From fabricating replacement parts to increasing the amount and variety of in-house printing, our employees look for ways to save money and then apply imagination and expertise to get the job done.

The following example illustrates the pattern.

Mountaintop Modules
To accommodate the installation of digital radio equipment for the new interprovincial digital radio system, additions to 19 existing microwave towers on mountain tops and in remote locations were required. Upgrades to the buildings

At the new BTE Business Sales Centre, located in the heart of downtown Vancouver, customers can check out the latest business terminal and office automation equipment.

and the heating, ventilating and air conditioning units were also required at 12 sites.

Rather than have contractors work on site, Supply, Transportation and Buildings people designed, built and tested modular add-on units in Vancouver which were then delivered and connected to the existing buildings at a savings of many thousands of dollars.

Operating Efficiently

There is a direct relationship between controlling costs and operating efficiently but effective operation has additional significance for the performance of the B.C. Tel Group.

It means that the members of the Group are able to coordinate their individual efforts to accomplish major projects such as Expo 86. It means that the energies and expertise of individual employees make a straight-line contribution to targeted objectives and that the objectives of each Group member contribute to the larger goals of the total Group.

Operational Effectiveness Program

The Company's operational effectiveness program, which was implemented in 1986 and is on-going, assists departments in examining their own procedures and operational effectiveness.

In Telephone Operations, operational support services now amalgamates the general service department of customer service, network service, and operator services to increase effectiveness in supporting line operations with methods, operational standards, procedures as well as recognized expertise.

Inventory Management

A new Materials Management Information System — MMIS II — moved from the planning stage to the beginning of implementation in 1986. The new system which is targeted for completion in 1987 will integrate all the supply functions of Supply, Transportation and Buildings and control inventory costs involved in keeping track of the 300,000 stock-keeping units which make up the $300 million worth of supplies purchased each year for Company operations. MMIS II will mean better service at less cost and that improves the efficiency of all Company operations which depend on these supplies.

Second Data Centre

Almost every department in B.C. Tel relies on computer systems to handle its work load and the volume of this work load plus the consideration of disaster planning have made a second data centre essential. In 1986 data centre II assumed part of the responsibilities for the enormous job of transforming data into useful information. In support of the Company's operations, the data centres run some 120,000 jobs on their large, main-frame computers each month generating telephone bills, paycheques, shareholder dividends and interest payments among the hundreds of thousands of items produced.

The two data centres are now linked through the hyper channel light guide (fibre optic) network and massive amounts of information can be transferred between the two centres quickly. Increased operational effectiveness is being achieved through reduction in transportation costs, faster responses and higher throughputs with each data centre acting as a backup for the other.

SBU For Microtel

During 1986, Microtel formed four key Strategic Business Units (SBU) to position itself effectively in its various competitive markets. These units are: Network Products — the manufacture of switching and transmission equipment; Satcom/Network Management which includes satellite, integrated network management systems and DAXCON; the Electronic Products Group of Manutronics, Lentronics and Viscount Industries; and Microtel Learning Services which provides and sells instructor and computer based training.

Information, vital to the efficient operation of B.C. Tel, is stored efficiently and safely in the data centres.

Getting It All Together ... For Our Customers

Providing a reliable, high-quality network containing advanced technology is basic to meeting the needs and wants of our customers. Anticipating and understanding the many wants and needs of our customers is also essential if we are to continue to operate successfully in a competitive environment.

In 1986, the Company made substantial progress in improving the network and in gaining customer satisfaction.

87% In '86!

B.C. Tel's long-term program of converting to electronic switching made rapid progress in 1986. By year-end, approximately 87% or 1.4 million of B.C. Tel's customer lines were served by electronic switching.

World's Largest

When it converted North Vancouver's 50,000 line central office to electronic switching in 1986, B.C. Tel employed the world's largest single GTD-5 EAX switch ever installed.

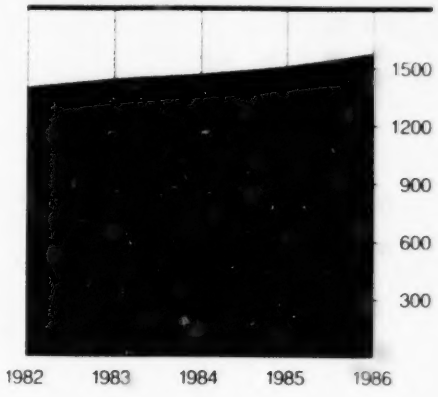
The GTD-5 hardware for the North Vancouver office was manufactured in Microtel's Brockville, Ontario facility and installed by Canadian Telephones and Supplies personnel.

Other large offices converted in 1986 included Trinity (46,000 lines), New Westminster (45,000 lines), Port Moody (23,000 lines) and Vernon (20,000 lines). The telephone test equipment used in connection with the GTD-5 switches is manufactured by Viscount Industries — a subsidiary of Microtel.

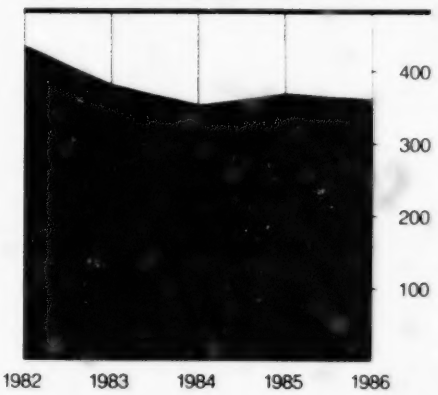
Customers served by B.C. Tel's digital electronic switches now have the option of adding such custom calling features as call alert, call forward, speed calling and three-way calling.

More important than these optional features however, is the improved quality of service provided to our customers. These improvements in our technical equipment plus the dedication of our employees resulted in a customer-satisfaction level of 95% in 1986 — a new high.

Conversion of Customer Lines to Electronic Stored Program Control (ESPC) *(Thousands of Lines)*



Source of Funds Used for Construction *($ Millions)*



Among the members of B.C. Tel's Board of Directors who attended the official opening of Columbia Area's new headquarters building in Kelowna, were Gordon MacFarlane, John Pitts and Rendina Hamilton.

First In Canada
B.C. Tel was first in Canada to provide customers calling directory assistance with a computerized automatic number identification system. This system automatically displays and records a caller's number, eliminating the need for operators to request the number and thwarting callers who deliberately give incorrect numbers to avoid paying directory assistance charges when applicable.

Another First
B.C. Tel was the first telephone company in Canada to install the new Automatic Audio Intercept Response system for directory assistance. With this system, a computer-generated 'voice' supplies the requested information. If the caller has problems or wishes additional information, an operator takes over. For the customer, the result is faster response time and accuracy.

Downtown Light Guide System
By anticipating the needs and demands of large business customers in the downtown Vancouver core area, B.C. Tel gained a competitive advantage with its introduction of a light guide transmission network to selected major office buildings.

The latest technology and effective teamwork enabled B.C. Tel to provide direct light guide links to its customers in eleven office buildings in 1986. By 1990, this network will be expanded to serve a minimum of fifty buildings and will handle the voice, data and video requirements of our largest customers for many years.

Business Communications Service
Burrard Area, which contains a large proportion of the province's largest businesses within its boundaries, created an organization which is responsible for the administration and control of all work functions involved in supplying and maintaining services provided to large businesses and special services customers. The objective is to meet the special needs of these businesses in a fast, proficient manner.

Customer Data Base
B.C. Tel's customer data base completed its first full year of operation in 1986. It provides the Company with full flexibility in its billing production capabilities and enables the Company to meet the many special requirements of its customers, especially large businesses.

The Card Reader Phone
During Expo 86, B.C. Tel market-tested a state-of-the-art type of public telephone called 'Card Phone'. New telephone technology enables the customer to use the magnetic-striped Telecom Canada and AT&T calling cards as well as American Express, Visa and Mastercard charge cards. Use of these cards minimizes the chance of fraud. Returns from the fifty Card Phones, installed initially, exceeded projected revenues by some 66%. The project involved people from Network, Network Marketing, Engineering Standards, Customer Service, Management Information Services, Accounting Operations and Treasury working together to provide improved customer service.

'Partyline'
In 1986, B.C. Tel introduced 'Partyline' — a service new to Canada. The service, which is still on a trial basis, was suggested by Ed Walker, Fraser Area personnel manager who later determined its existence in other countries. Partyline functions as a medium for social gatherings — by phone — with as many as ten participants, usually teenagers, sharing a Partyline. With several thousand calls per day being billed, the service obviously meets a previously unrecognized customer demand and has proved to be extremely popular.

Some of these office towers on the skyline of downtown Vancouver are now linked to B.C. Tel's facilities by light guide transmission systems. By the end of the decade it is expected that some fifty major buildings will enjoy the benefits of this new technology.

Ferry Phones
Engineering technicians in Radio Engineering custom designed, built and programmed much of the equipment involved in automating the coin telephones used on the B.C. Ferries and did it in time to meet the Expo 86 rush of tourists. In addition to generating tourist revenues, these radio-operated automated phones have eliminated the need for operator intervention on the majority of local Nanaimo, Vancouver and Victoria calls, thereby reducing operator costs.

Faster Restoral Time
Working for the customer takes many forms throughout the Company. Thanks to the efforts of one ingenious central office maintenance employee, Rick Lim, the time needed to restore long distance trunk circuits has been reduced dramatically. By adjusting the software in the GTD-3 digital toll switch, testing time has been cut and customers are less likely to hear the 'all circuits are busy' recording when attempting to place a long distance call. That means better service.

'Welcome', Customers
Most of B.C. Tel's Phone Mart stores underwent extensive renovations during 1986 with redesigned interiors and contemporary fixtures and displays. The Phone Mart provides 'one-stop-shopping', primarily for our residential and small business customers who can obtain all consumer telephone products and basic network service under one roof. This concept and the knowledgeable, service-oriented personnel in these stores have gained widespread customer approval and support.

Listening And Learning
Perhaps the most important and effective method of increasing customer satisfaction is the simplest. We listen to what the customer tells us, learn about the particular needs and circumstances and then make every effort to meet those needs to the customer's satisfaction.

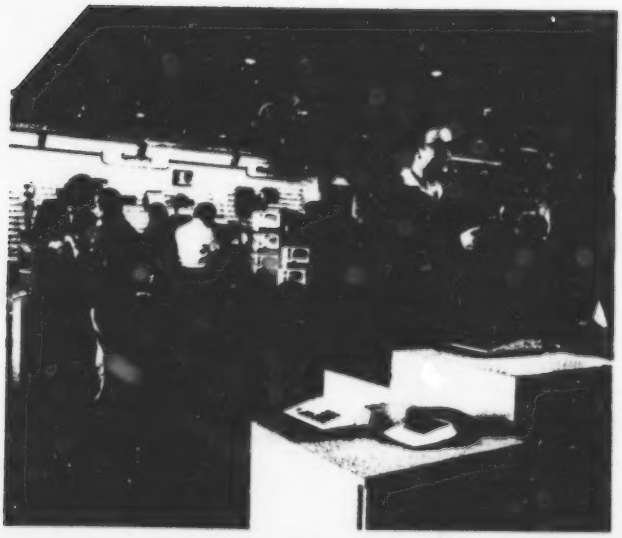
Our results for 1986 are clear evidence of the value and validity of our philosophy and practices which are based on the dictum, 'what is good for the Company is good for the Customer'.

Area Management Changes
Carl Swabey who was Area General Manager — Columbia retired on August 31, 1986. Coincident with his retirement, there were changes in responsibilities for Don Haaheim, formerly Area General Manager — Mackenzie, who replaced Mr. Swabey and for Ken McLean, formerly Area Operations Manager — Mackenzie, who was appointed Area General Manager — Mackenzie.

Carl Swabey

Don Haaheim

Ken McLean



Contemporary products in a contemporary setting greet customers in renovated Phone Marts stores such as this one in east Vancouver.

Getting It All Together ... For Our People

B.C. Tel has long recognized that, in the equation, 'Advanced technology plus good people equals a successful telecommunications enterprise', the most important word is 'people'.

Just as the Company must be customer-oriented externally, it must be people-oriented internally. Those two orientations have been part of B.C. Tel's changing corporate culture.

It is part of B.C. Tel's goal of Excellence 'to provide meaningful work, challenging opportunities and satisfying careers for our employees'.

Our employees want more than the basics of a safe work place, reasonable compensation for their efforts and adequate equipment and tools to perform their work. They want to have the skills and training needed to take advantage of new opportunities and make enlightened career moves. They want to be part of the process — to understand and contribute to changes and developments in how the Company does business and in the business it does. And, they want to have their contributions recognized.

A sampling of a few of the activities and efforts which contributed to greater employee satisfaction and improved morale in 1986 are described below.

Employees As Students

B.C. Tel's Education Centre is not only one of the largest privately-owned institutions of adult education in Canada, it is also widely recognized as one of the best.

During 1986, employees participated in some 16,000 course-units offered by the Education Centre. The hundreds of different courses ranged from engineering training and business management to a special course for the hosts, hostesses and crowd controllers working at the Telecom Canada Pavilion during Expo 86.

New Technologies In Training

In response to increasing demands for more decentralized and flexible training, B.C. Tel has used the resources of Microtel Learning Services to develop PC-based computer based training curricula in leading technology areas such as data communications and light guide systems.

Toward Excellence

The Education Centre has the responsibility for nurturing the Toward Excellence concept within the Company. In 1986, more than a thousand managers participated in the training program used in connection with this concept.

B.C. Tel's Toward Excellence credo is printed on page 20 of this report.

The 'Values and Vision' statements are being used routinely to assist managers in making key decisions.

Quality Circles

The Quality Circle process was introduced to B.C. Tel in 1981. Together with other processes and strategies — such as Toward Excellence and Best — Quality Circles help broaden organizational thinking through the promotion of an important ingredient — employee participation.

Joining a Quality Circle is entirely voluntary — growth rates are determined by employee interest. From one Quality Circle in 1981, the number has grown to 90 active Circles.

Modern equipment and modern methods ensure effective training for participants in courses conducted by Microtel Learning Services.

A Circle In Action
In 1986, the Discovery Circle from Campbell River operator services took on a project designed to bring B.C. Tel operators closer to their customers. Recognizing that emergency telephone service is particularly important in remote locations, group members contacted all 170 fixed stations served from their area, pinpointing the site location, listing the customer's emergency resources and identifying neighboring stations — information that could prove invaluable in an emergency. This initiative was warmly received by the customers.

Fitness
In its tenth year of operation, 1986, the Company's Employee Fitness program was enlarged substantially. New on-site facilities were put in place in three additional Company locations and community-based incentive programs launched in Nanaimo and Terrace.

Some 2,000 employees now participate in programs ranging from aerobics to nutrition.

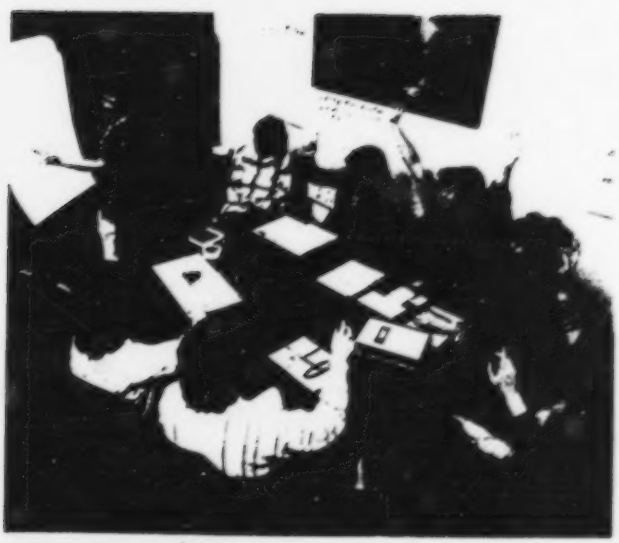
Safety
Safety on-the-job is an on-going concern of the Company and safety training, first-aid courses and competitions and awareness programs are year-in year-out activities.

Part of the job for many employees is moving from point to point aboard one of the Company's aircraft. The safety factor for such flights was increased in 1986 with the implementation of Flight Watch. This system — custom designed in Radio Engineering — provides the flight operations dispatcher with instant communication to the Company's aircraft throughout the province. Using the Flight Watch system, pilots can report position or any abnormality at any time and conduct flight checks whenever they are required.

'Star'
A program designed to encourage active and retired B.C. Tel people to submit ideas to improve B.C. Tel's operating efficiency and to give employees an opportunity to participate in the progress of the Company was put in place in 1986. The 'Suggestions That Achieve Results' (STAR) program gives employees a vehicle to put forward their ideas and provides cash awards for successful suggestions.

Open Houses
On various occasions throughout the year — such as marking the 50th anniversary of Canadian Telephones and Supplies — the Company hosts open houses on its premises so that employees can share their work environment and experience with families and friends.

Keeping Informed
The people of B.C. Tel are kept informed of developments and Company activities through a number of communication vehicles including B.C. Tel News, bulletins, area newsletters, Newsline, Video Newsmagazine, Infonet and the employees' annual report. Two of these employee communications vehicles received national recognition in 1986. The employee annual report won the Silver Leaf Award of Excellence from the International Association of Business Communicators (IABC) as the best employee annual report in Canada. B.C. Tel News was awarded honorable mention in the company newspaper category from the IABC.



Members of the Campbell River 'Discovery Circle' — one of more than ninety Quality Circles operating within the Company — meet to discuss their project.

Getting It All Together ... For The Future

Ours is a business which plans and builds for the future but which must be capable of meeting the sudden challenges, changes and opportunities which arise from day-to-day.

The flexibility and resourcefulness of our people enable us to meet successfully our day-to-day responsibilities, providing always that sufficient facilities are at hand; that training has been adequate and that our services and products have been given the competitive edge.

To supply those essential ingredients for success in the years ahead, the Company undertook a great many projects and programs in 1986 aimed at continuing the progress of the B.C. Tel Group.

Electronic Switching

The quality and capabilities of the network improve each year as more and more lines are served by electronic switching. In addition to the major conversions of base units, remote switch units are placed in smaller serving areas. By 1990 conversion to electronic switching will be virtually complete throughout B.C. Tel's serving area.

Glass Cables

High capacity light guide systems are spreading throughout the B.C. Tel network as the transmission medium of the future. In one project in the Columbia area, a light guide system of some 222 kilometres will link Kelowna and Kamloops by July 1987. In the Mackenzie Area a system of some 95 kilometres will be installed by 1988.

Specialized applications, such as the downtown Vancouver network of office buildings linked to our facilities by a light guide system will be expanded.

From Our R&D Arm

Innovative design and development are the hallmarks of Microtel's new products and of the Microtel subsidiary, Microtel Pacific Research (MPR). With close cooperation from B.C. Tel, Microtel has developed a new network element known as the Digital Access Cross Connect (DAXCON). B.C. Tel began installation of this product in 1986 and it will be a key element in a new network — the Digital Services Transport Network (DSTN). A DAXCON support system is also being developed to manage and maintain the DSTN. The DSTN network provides a cost-effective means of increasing network utilization and reducing manual testing and wiring. It will enable B.C. Tel to respond quickly to customers' needs for new digital services. A DAXCON 16 system, marketed in conjunction with Amdahl Communications Inc. of Ontario, will expand Microtel's presence in the United States.

Microtel will also be marketing its DS2100 satellite data communications network terminal in 1987. The DS2100 is the latest member of the Microtel Spacetel family of products and combines the economy of Very Small Aperture Terminal design with the proven performance of Spacetel to solve key problems facing data communications network managers. With this product, Microtel becomes the first Canadian company to offer low cost, interactive, satellite-based data networking capability.

There are many technologies employed in the development of sophisticated telecommunications products. The expertise and initiative of Microtel and MPR continue to provide both a focus and supportive base for the further development of these technologies in British Columbia.

The 'clean room' at the Pacific Microelectronics Centre — the first facility of its kind in Western Canada — is used to design, test and package Very Large Scale Integrated microcircuitry.

International Electronic Messaging
A technical group of the International Radio Consultative Committee (CCIR), headed by Mike Callendar of B.C. Tel's technical staff, is using Telecom Canada's electronic messaging service — Envoy 100, with Datapac access from around the world, in a study of the requirements for future world-wide 'personal' cellular systems. The use of this innovative system has helped to solve the communications problems associated with coordinating the efforts of some 60 people in 24 different countries for distribution of administrative and technical material used in the study.

Structural Separation
An appeal, currently under consideration by the Canadian Radio-television and Telecommunications Commission (CRTC), has implications of some significance for B.C. Tel shareholders.

In Telecom Decision CRTC 86-5, dated March 20, 1986, the CRTC ruled that a costing approach rather than structural separation may be used by B.C. Tel for the provision of multiline and data terminal equipment.

This approach relies on costing procedures to identify a separate revenue/cost category for multiline and data terminal equipment services. The category will be expected to recover its causal costs, and to make a contribution to fixed common costs of the Company. Any excess or shortfall after this contribution will accrue to, or be borne by, the shareholders. The Commission intends to eliminate the requirement for filing tariffs once these costing procedures are implemented.

The Company has filed an appeal of the decision with respect to the issue of business inside wiring costs. The appeal states that the Commission may not have fully considered the difference in accounting methods used by Bell Canada and B.C. Tel in depreciating inside wiring investments. Bell Canada will have fully depreciated its business inside wiring by the time the decision is implemented. On the other hand, B.C. Tel will have on its books a large amount of unrecovered capital invested in business inside wiring.

Consequently, the Company's competitive terminal-multiline and data operations would have to bear the high costs associated with this unrecovered investment. As these operations are extremely competitive, prices for products cannot be adjusted to compensate. The result would be a shifting of the burden of these costs to B.C. Tel shareholders.

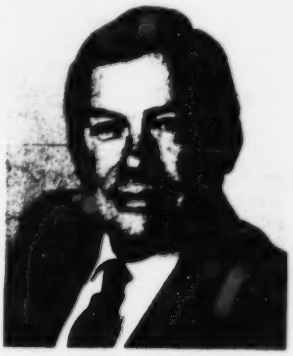
The appeal notes that the effect of the CRTC decision would be to treat Bell and B.C. Tel differently as to the recovery of the cost burden of inside wiring. B.C. Tel has proposed that these costs be included as part of the overall revenue requirement, thereby treating the Company the same as Bell Canada in this matter.

Internal Quality
The 'Best' strategy, which is part of the B.C. Tel Group's corporate culture, focused initially on quality improvements for customers. The strategy is expanding to consider internal quality — that is the quality of the service which groups within the Company provide for each other. The same criteria apply when measuring internal quality — providing quality products and services; meeting schedules; being thorough; meeting the other party's objectives; being prompt, courteous and helpful.

An improvement in internal quality leads inevitably to improvements in overall efficiency and to a more productive work environment.

Corporate Culture
Changing corporate culture is not accomplished overnight. However, it is being accomplished as more and more people in the B.C. Tel Group subscribe to and support the philosophies and practices inherent in our Toward Excellence and Best goals. Changing attitudes, improved practices and growing awareness of our 'customer-first' orientation will continue to expand with the stimulus of the programs and training executed in 1986.

Board Of Directors
A change in the membership of the Company's Board of Directors was announced at the Annual General Meeting, held on March 20, 1986. W. Robert Wyman was elected to the Board to fill the vacancy created by the retirement of Hugh R. Stephen.



W. Robert Wyman

Looking Ahead

Although we have made every effort to buttress this Company against the effects of an uncertain economy, a realistic appraisal of conditions in our province suggests that the year ahead will test our defences.

World and domestic events and developments had serious effects on British Columbia's forest and mining industries in 1986 and continue to threaten the very moderate improvement originally projected for the provincial economy in 1987.

It is of no comfort to note that the depressing effect of developments in our resource industries only serves to underline the need for a much broadened economic base for the

province. Our industry has the potential to contribute to that broadened base and, to the extent that a single corporation can contribute, the B.C. Tel Group continues to support and nurture its own high technology ventures and cooperate with both levels of government in seeking new or expanded opportunities to benefit from the information economy.

One such initiative is a proposal to establish a commercial centre of microelectronics excellence which would be managed and operated as a private company owned initially by three of British Columbia's larger electronics companies and agencies of the federal and provincial governments with participation from the province's major universities. Microtel Pacific Research would be one of the partners in this enterprise which would provide the microelectronics infrastructure needed to enlarge the base of the province's electronics industry.

Within our own industry, B.C. Tel will continue to operate in an environment that is becoming increasingly competitive. New entrants and new products challenge our ability to retain or increase our overall share of the competitive market. A changing regulatory climate — demonstrated by recent decisions — has the potential to place some portions of our traditional revenue base at risk.

However, we intend to defend that base against competition and seek new and profitable areas for expansion.

What our Company requires most is a realistic pricing system for those services and products which fall within the sphere of regulatory control. Such a system must be workable and must balance — to the greatest degree possible — the needs of all our customers with the legitimate needs of our Company. We consider that a restructuring of local and long distance rates is a prerequisite of such a system and we continue to press for action in this area.

We look to improved results from the marketing of the services and products associated with Telephone Operations in the year ahead. Innovative and practical strategies are being implemented in a determined manner to ensure that this core of our business continues to provide the bulk of our revenues.

Other members of the B.C. Tel Group should experience a year of continuing growth.

Microtel, which has spent several months in realignment, is now in position to take advantage of the marketing opportunities afforded by its industry-leading products. Microtel Learning Services has expanded and will continue to contribute to corporate revenues as will Business Telecom Equipment and Telecom Leasing Canada. B.C. Cellular is still in its early growth period but its aggressive marketing activities and the backing of B.C. Tel's reputation for service should see it meeting its revenue objectives.

On the technical side, our network is being provisioned to accommodate and exploit new technological developments as they occur for the benefit of our customers and our owners.

The on-going expansion and improvement of the network will continue to require the investment of large sums of money. Much of this can and will come from internal sources. To raise the balance of the funds required in a prudent manner, we will have to ensure that we present an attractive investment picture to the financial community. Our efforts to increase revenue and contain costs as a means of presenting this picture will have high priority in the year ahead.

Negotiations with the Telecommunications Workers Union for a new contract to replace the one which expired on December 31, 1986 have been completed. With goodwill on both sides, it was possible to obtain an agreement which was acceptable to both parties.

Although this report may appear to focus too narrowly on the nuts and bolts — or, more accurately, the bits and bytes — of our business and on a sampling of the thousand and one activities and accomplishments which constitute a year in the life of B.C. Tel, the reality is that we are horizon seekers.

The people in the B.C. Tel Group have glimpsed the possibilities and promises of the entrepreneurial Information Age and are aware of the role that telecommunications can and must play to turn those promises into performance.

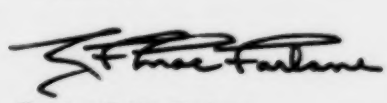
The spirit of discovery is very much alive in your Company as is the determination to explore the limits of the full potential of the technologies of today and tomorrow.

We continue to expand a base for the Company which is built solidly on a prudent selection and effective application of efficient and appropriate technology and the demonstrated excellence of our people at all levels and within every segment of the B.C. Tel Group.

The directors are confident that this base will serve the Company, its owners, its customers and its people responsibly and profitably in the years ahead.

The directors wish to commend the people of the B.C. Tel Group for the individual and collective efforts which have resulted in the achievements of 1986.

On behalf of the Board of Directors,



Gordon F. MacFarlane
Chairman and
Chief Executive Officer
Burnaby, British Columbia
February 11, 1987

Expo 86
A B.C. Tel Success Story

The B.C. Tel Group can claim part of the credit for the outstanding success of Expo 86 — the world exposition of transportation and communications — which attracted more than twenty-two million visits to its sparkling site in downtown Vancouver.

B.C. Tel provided the essential communications infrastructure for Expo 86 and, in doing so, conquered a host of difficulties which had plagued previous world fairs.

B.C. Tel's success in handling this major project was made possible by the availability of exceptional technological resources and the expertise of the people of the B.C. Tel Group working in a host of telecommunications disciplines.

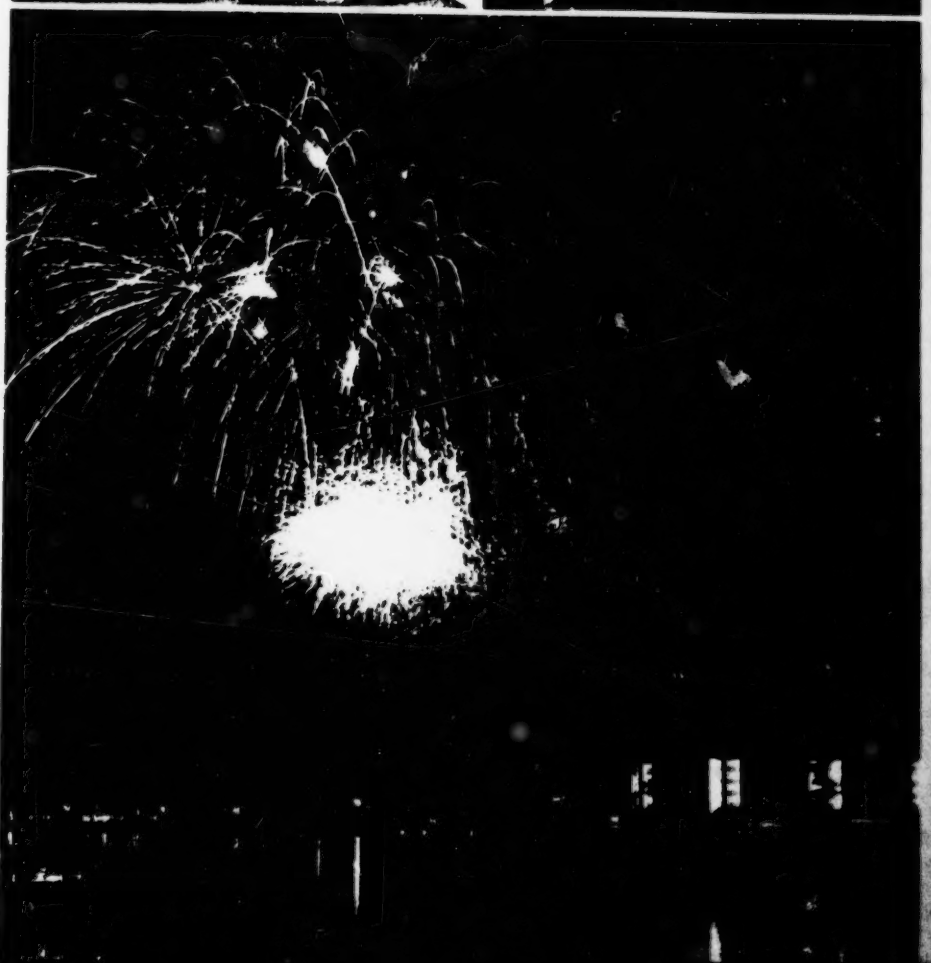
The statistics tell part of the story. By opening day, May 2, 1986, B.C. Tel had provided Expo with 2,800 equipment items ranging from basic telephones to switchboards and a Centrex service; more than 400 coin phones including the new Card Phones; over 300 special services; more than 50,000 pair-kilometres of copper cable as well as light guide systems and coaxial cable for broadcast use as required. On opening day, B.C. Tel supplied 51 simultaneous video channels from 91 camera locations to 83 countries.

Employees from the B.C. Tel Group provided uninterrupted on-site repair and maintenance service throughout the five-and-a-half month run of the exposition.

B.C. Tel coordinated all aspects of the Telecom Canada Pavilion which attracted more than 2.7 million visits to become one of the top attractions of Expo.

In addition to on-site service requirements, Expo generated increased off-site service demands and long distance business.

The other part of B.C. Tel's Expo experience was a feeling of pride and satisfaction. We were able to demonstrate convincingly and on a world stage, the high calibre of our people, the excellence of our products and the expertise of our services. That is a legacy of Expo 86 which will continue to contribute to our progress.



Telecom Canada Pavilion Commissioner J. A. MacInnes and Mrs. MacInnes were among the dignitaries welcoming the Prince and Princess of Wales on the opening day of Expo.

B.C. Tel's on-site services were well patronized throughout the run of the exposition.

The finale — Expo ends in a blaze of color.

'opposite page'

Some of the B.C. Tel people whose exceptional efforts produced an exceptional Expo.

Crowds waiting to experience the ever-popular Telecom Canada Pavilion's 'Portraits of Canada' production.

Toward Excellence

British Columbia Telephone Company

Our Values

Our goal is excellence.

We have a fundamental commitment to:

— customer satisfaction

— quality, integrity and pride in all we do

— the effective application of technology.

This commitment — by dedicated, competent, innovative people — enables us to deliver full value in telecommunications, thereby earning the confidence of our customers and the support of our investors.

Our Vision

We will carry on three core businesses:

— the provision of telecommunications services through Telephone Operations

— the marketing of business-communications and office-automation products and services through BTE and B.C. Cellular

— the manufacture of telecommunications equipment and research in related areas through Microtel and it subsidiaries.

Embryonic and developing businesses will be nurtured and, where viable, developed to take advantage of new markets and opportunities.

The sum of these components will be a single enterprise — The B.C. Tel Group — with a single corporate vision:

— that our people in each component of the enterprise work cooperatively and harmoniously to optimize benefits for our customers, our employees and our shareholders so that the B.C. Tel Group, as a strong, successful telecommunications entity, can make a valuable and lasting contribution to our province and our country.

Broad and diversified sources of revenue are held to be fundamental to the long-term health and viability of the B.C. Tel Group.

Our Standards

Our long-term success will be measured by the ways in which we:

— carry out our commitment to provide our customers with quality products and services

— provide meaningful work, challenging opportunities and satisfying careers for our employees

— conduct all our affairs in accordance with the highest standard of integrity

— meet the expectations of our shareholders for a fair return on and growth in the value of their investment

— contribute to the quality of life wherever we do business and otherwise recognize and respond to our social responsibilities.

By conducting our business in a manner consistent with our values, our standards and our vision, we believe we can assure and share in the future success of the B.C. Tel Group.

Financial And Shareholder Information

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The Investment Cost and Manpower Section of the Accounting Operations has the responsibility of reviewing and evaluating the [illegible] operating expenditures for the Company.

Financial Review

CONSOLIDATED EARNINGS

Consolidated earnings for 1986 were $113.9 million, up from $97.5 million in 1985. This is equivalent to $2.46 per average ordinary share compared with $2.21 in 1985 while reflecting a 4.7% increase in the number of average outstanding ordinary shares in 1986.

These improved results were attained in a gradually strengthening provincial economy which was aided by Expo 86. During this year, Microtel's net earnings have moved from a loss position in 1985 to a marginal profit.

TELECOMMUNICATIONS OPERATIONS

Operating Revenues

Operating revenues for the year grew by 7.5% from $1,217.0 million in 1985 to $1,308.0 million in 1986. This growth is mainly attributable to a 9.5% gain in toll revenues and more specifically to a 7.8% increase in long distance calling volumes which grew consistently throughout the period.

Local service revenues also improved, increasing 4.0% while customer lines in service were up by 3.5%.

Local service revenues increased from $459.0 million in 1985 to $477.4 million in 1986 and long distance service revenues totalled $705.7 million in 1985 compared to $772.5 million in 1986.

Uncollectible operating revenues have decreased from 1.3% of gross operating revenues in 1985 to 1.2% this year.

Operating Expenses

Operating expenses amounted to $922.3 million, a 5.3% increase over the $876.0 million in 1985. A 6.5% increase in depreciation expense was offset in part by a 2.1% reduction in operating taxes. This reduction in operating taxes included a 7.8% increase in payroll taxes and a 6.1% reduction in property taxes. Controllable operating expenses were held to an increase of $31.2 million or 5.5% and reflects the continuing program of cost containment practised throughout the Company in 1986. This increase primarily represents a 4.0% salary and wage scale increase that became effective on January 1, 1986 and reflects a 2.0% reduction in the telecommunications workforce since the end of 1985 through restricted hiring, an early retirement incentive plan and normal attrition.

MANUFACTURING OPERATIONS

Sales

Microtel's annual sales in 1986 were $170.7 million, an increase of 1.9% over 1985 sales of $167.5 million. This increase reflects 1986 sales of new products which offset the elimination of unprofitable products in 1985 and substantially improved sales in the fourth quarter including revenue on the North Warning contract.

Costs and Expenses

Cost of sales totalled $136.6 million in 1986, down significantly from 1985 costs of $148.2 million.

This reduction in on-going costs reflects the impact of the restructuring program and the improved product margins resulting from better operating efficiencies. Selling and administrative expenses were held to less than a 1% increase this year.

DEBT SERVICE COSTS

Consolidated debt service costs increased from $116.3 million in 1985 to $117.3 million in 1986. Higher interest costs on long-term debt in 1986 reflected the net increased levels of bonds outstanding during the year, due to the issue of $125.0 million of Series AL bonds in November 1985 and a $20.0 million Series J (low coupon) bond maturity in July 1986.

However, total debt service costs were contained to less than a 1.0% increase by reduced levels of short-term debt outstanding, primarily as a result of the $80.4 million issue of ordinary shares in June 1986.

INCOME TAXES

Income tax expense increased by 30.3% in 1986, to $142.2 million compared with $109.1 million in 1985. The primary reasons for the increase were the higher taxable earnings in 1986, coupled with an increase in the tax rate for the year from 52.9% in 1985 to 53.8% in 1986.

NET EARNINGS AND DIVIDENDS

Consolidated net earnings increased from $115.9 million in 1985 to $130.5 million in 1986.

Dividends on preferred shares decreased to $16.6 million from $18.4 million in 1985, reflecting the redemption of preferred shares during 1986. After the provision for preferred share dividends, 1986 net earnings for ordinary shares amounted to $113.9 million compared to $97.5 million in 1985. Ordinary share dividends increased 4.9% to $79.8 million from $76.1 million in 1985 due to the increased number of shares.

The balance of 1986 retained earnings, after deducting expenses of $.8 million incurred to issue additional shares, amounted to $33.3 million compared to $21.4 million in 1985.

RATES OF RETURN

The rate of return on average invested capital increased to 11.24% from 10.86% in 1985. Similarly, the rate of return on average ordinary share equity increased to 12.65%, from the corresponding 1985 return of 12.01%.

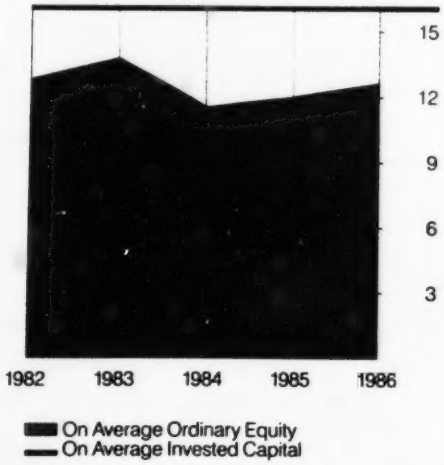
CHANGES IN FINANCIAL POSITION

The internal generation of funds required to finance the annual construction program increased from 82% in 1985 to 85% in 1986. This improvement resulted mainly from an increase in depreciation as a source of funds from operations.

The balance of funds required were secured through external financings of $92.0 million, including a mid-year issue of 2,950,000 ordinary shares and the issue of 463,722 ordinary shares through the Dividend Reinvestment and Share Purchase Plan and the Employee Share Purchase Plan. Offsetting reductions for bond maturities and preferred share redemptions totalled $46.1 million.

As a result of these financial changes during 1986, the Company's consolidated debt ratio was reduced to 49% of capitalization from the 1985 year-end ratio of 51% and total ordinary equity has increased from 38% to 41%.

Rates of Return *(Percentage)*



Sending the bills out... Modern mailing equipment speeds the process of getting bills out to B.C. Tel's thousands of customers.

Management Report

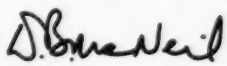
To Our Shareholders:

Management is responsible to the Board of Directors for the preparation of the consolidated financial statements of the Company and its subsidiaries. These statements which have been prepared in accordance with generally accepted accounting principles necessarily include some amounts based on estimates and judgements. Financial information presented elsewhere in this Annual Report is consistent with that in the consolidated financial statements.

The Company maintains a system of internal control which provides management with reasonable assurance that assets are safeguarded and that reliable financial records are maintained. This system includes written policies and procedures, an organizational structure that segregates duties, and a comprehensive program of periodic audits by the internal auditors. The Company has also instituted policies and guidelines which require employees to maintain the highest ethical standards.

The Company's independent auditors, Arthur Andersen & Co., have been appointed by the shareholders to express an opinion as to whether these consolidated financial statements present fairly the Company's consolidated financial position and operating results in accordance with generally accepted accounting principles applied on a consistent basis. Their report is included below.

The Board of Directors has reviewed and approved these financial statements. To assist the Board in meeting its responsibility, it has appointed an audit committee which is composed entirely of outside directors. The committee meets periodically with management, the internal auditors and the independent auditors to review internal accounting controls, audit results and accounting principles and practices.



D. B. McNeil
Vice-President –
Corporate Finance

Auditors' Report

To The Shareholders Of British Columbia Telephone Company

We have examined the consolidated balance sheet of BRITISH COLUMBIA TELEPHONE COMPANY (incorporated under an Act of the Parliament of Canada) and subsidiaries as of December 31, 1986 and 1985, and the consolidated statements of earnings, retained earnings and changes in financial position for the years then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, the accompanying consolidated financial statements appearing on pages 25 to 38, inclusive, present fairly the financial position of the Company and subsidiaries as of December 31, 1986 and 1985, and the results of their operations and the changes in their financial position for the years then ended in accordance with generally accepted accounting principles applied on a consistent basis.

Vancouver, B.C.
January 26, 1987

ARTHUR ANDERSEN & CO.,
CHARTERED ACCOUNTANTS

Consolidated Statement Of Earnings

For The Years Ended December 31

		1986	1985
		($ Millions)	
Telecommunications Operations			
	Operating Revenues *(Note 2)*	**$1,308.0**	$1,217.0
	Operating Expenses *(Note 3)*	**922.3**	876.0
	Telecommunications Operating Earnings	**385.7**	341.0
Manufacturing Operations			
	Sales	**170.7**	167.5
	Costs And Expenses		
	Cost of sales	**136.6**	148.2
	Selling and administrative expenses	**30.0**	29.8
	Less — Other income — net *(Note 4)*	**.2**	10.8
		166.4	167.2
	Manufacturing Operating Earnings	**4.3**	.3
Combined Operating Earnings		**390.0**	341.3
	Debt Service Costs — Net *(Note 5)*	**117.3**	116.3
	Earnings Before Income Taxes	**272.7**	225.0
	Income Taxes *(Note 6)*	**142.2**	109.1
	Net Earnings	**130.5**	115.9
	Less — Preference and preferred share dividends	**16.6**	18.4
Ordinary Share Earnings		**$ 113.9**	$ 97.5
Earnings Per Ordinary Share			
	Basic	**$ 2.46**	$ 2.21
	Fully diluted *(Note 1a)*	**$ 2.46**	$ 2.20
Average Ordinary Shares Outstanding		**46,263,000**	44,204,000

Consolidated Statement Of Retained Earnings

For The Years Ended December 31

	1986	1985
	($ Millions)	
Balance at beginning of year	**$ 256.1**	$ 234.7
Ordinary share earnings	**113.9**	97.5
	370.0	332.2
Less — Ordinary share dividends	**79.8**	76.1
— Share issue expense	**.8**	—
Balance at end of year	**$ 289.4**	$ 256.1

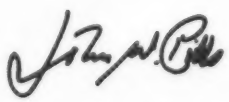
Consolidated Balance Sheet

As Of December 31

Assets		1986	1985 ($ Millions)
Telecommunications Property, *at cost*			
	Buildings, plant and equipment *(Note 9b)*	**$3,769.4**	$3,550.4
	Less — Accumulated depreciation	**1,234.0**	1,131.3
		2,535.4	2,419.1
	Land	**27.4**	27.2
	Property under construction	**109.9**	159.7
	Materials and supplies	**42.0**	38.7
		2,714.7	2,644.7
Manufacturing Property, *at cost*			
	Plant and equipment	**92.1**	80.7
	Less — Accumulated depreciation	**43.0**	37.6
		49.1	43.1
		2,763.8	2,687.8
Investments And Other Assets, *at cost*			
	Telesat Canada	**3.3**	3.3
	Instalment contracts and other	**34.5**	24.8
		37.8	28.1
Current Assets			
	Accounts receivable	**240.9**	224.2
	Inventories *(Note 7)*	**37.9**	41.3
	Prepaid expenses	**15.6**	14.4
		294.4	279.9
Deferred Charges			
	Unrealized deferred losses on foreign exchange, less amortization	**10.2**	12.7
	Cost of issuing debt securities, less amortization	**9.1**	10.5
		19.3	23.2
		$3,115.3	$3,019.0

Approved by the Directors,

Director



Director

Capitalization And Liabilities		1986	1985
		($ Millions)	
Capitalization			
	Equity *(Note 8)*		
	Ordinary shares	**$ 971.5**	$ 845.3
	Preference and preferred shares	**219.4**	242.1
	Total equity	**1,190.9**	1,087.4
	Long-term debt *(Note 9)*	**1,118.8**	1,101.3
		2,309.7	2,188.7
Current Liabilities			
	Cheques issued in excess of bank balances	**22.1**	29.3
	Short-term obligations *(Note 10)*	**36.5**	36.2
	Accounts payable and accrued liabilities	**172.1**	201.4
	Due to affiliated companies *(Note 15)*	**.9**	1.4
	Income taxes payable	**40.7**	40.5
	Dividends payable	**23.1**	21.8
	Unearned revenues	**46.8**	45.3
		342.2	375.9
Income Taxes Deferred		**463.4**	454.4
Commitments And Contingent Liabilities *(Note 13)*			
		$3,115.3	$3,019.0

Consolidated Statement Of Changes In Financial Position

For The Years Ended December 31

		1986	1985
		($ Millions)	
Cash From Operating Activities:			
	Operations:		
	Ordinary share earnings	**$ 113.9**	$ 97.5
	Add (deduct) items not involving a flow of cash:		
	Depreciation	**280.8**	264.0
	Income taxes deferred	**9.0**	29.2
	Allowance for funds used during construction	**(13.5)**	(13.7)
	Other, net	**(4.9)**	1.4
		385.3	378.4
	Less — Ordinary share dividends	**79.8**	76.1
		305.5	302.3
	(Increase) decrease in non-cash working capital *(Note 12)*	**(32.0)**	62.9
Cash From Financing Activities:			
	Ordinary shares issued	**92.0**	18.7
	Long-term debt issued	**29.4**	154.5
		121.4	173.2
	Redemptions or conversions of long-term debt and preferred shares	**(46.1)**	(42.9)
		75.3	130.3
Cash From Operating And Financing Activities		**$ 348.8**	$ 495.5
Cash Used In Investment Activities:			
	Gross capital expenditures	**$ 360.9**	$ 368.5
	Increase in materials and supplies capitalized	**3.3**	10.0
	Salvage value of plant retired, net	**(5.2)**	(7.6)
	Allowance for funds used during construction	**(13.5)**	(13.7)
Cash Used In Investment Activities		**$ 345.5**	$ 357.2
Cash Position:			
	Net increase during the year	**$ 3.3**	$ 138.3
	Beginning of year	**(59.5)**	(197.8)
	End of year	**$ (56.2)**	$ (59.5)
Represented By:			
	Temporary cash investment *(Note 10)*	**$ 23.7**	$ 49.1
	Bank indebtedness:		
	Cheques issued in excess of bank balances	**(22.1)**	(29.3)
	Short-term bank indebtedness and promissory notes *(Note 10)*	**(57.8)**	(79.3)
		$ (56.2)	$ (59.5)

Notes To Consolidated Financial Statements

1. Summary Of Significant Accounting Policies

The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in Canada, and in conformity with prevailing practices in the Canadian telecommunications industry. These statements conform in all material respects with International Accounting Standards.

The term "Company" is used to mean British Columbia Telephone Company and, where the context of the narrative permits or requires, its subsidiaries.

British Columbia Telephone Company is regulated by the Canadian Radio-television and Telecommunications Commission (CRTC). In its role as regulator, the CRTC sets allowable rates of return, approves equity financing, approves tariffs for certain of the Company's goods and services and periodically issues directives which affect the accounting treatment of specific items in the Company's accounts.

(a) **Earnings Per Ordinary Share**

Earnings per ordinary share have been computed based on the average number of shares outstanding each month during the period. Fully diluted earnings per ordinary share in 1985 reflected the potential full conversion of the $2.32 convertible subordinate preferred shares. Effective July 1986, all the $2.32 convertible subordinate preferred shares have been converted or redeemed.

(b) **Consolidation**

The consolidated financial statements include the accounts of the Company's wholly-owned subsidiaries, Microtel Limited (together with its wholly-owned subsidiaries, Viscount Industries Limited, and Microtel Pacific Research Limited), North-west Telephone Company (together with its wholly-owned subsidiary Telecom Leasing Canada (TLC) Ltd.), and Canadian Telephones and Supplies Ltd. The excess of the cost of shares of subsidiaries over the Company's equity at the date of acquisition is included in telecommunications property and is being amortized over periods not exceeding thirty years. Such amortization amounted to $700,000 in 1986 ($700,000 — 1985).

All significant intercompany transactions have been eliminated except for purchases of telecommunications equipment and supplies by British Columbia Telephone Company from Microtel Limited (Microtel) which are capitalized as equipment in the consolidated balance sheet at cost to the parent, and are included in manufacturing sales in the consolidated statement of earnings *(Note 15)*. To the extent that any income on these sales has not been offset by depreciation and other operating expenses, it remains in consolidated earnings and retained earnings.

(c) **Telecommunications Property**

Telecommunications property is recorded at historical cost and includes certain payroll costs and general overheads applicable to the construction activity. In addition, the Company capitalizes an amount for the cost of funds used to finance construction. This allowance for funds used during construction is included in income by way of an offset against debt service costs. The capitalization rate (defined by the CRTC as the rate of return on average invested capital earned by the utility during the preceding fiscal year) was 11.22% in 1986 (11.17% — 1985). Such income is not realized in cash currently but will be realized over the service life of the property.

When depreciable telecommunications property is retired, the amount at which it has been carried is charged to accumulated depreciation.

(d) **Depreciation**

Depreciation rates for telecommunications property are determined by a continuing program of engineering studies for each class of property, according to year of placing in service and estimated useful life. Depreciation provisions are calculated on a straight-line basis using such rates. The composite depreciation rate was 7.49% for 1986 (7.41% — 1985).

Depreciation on manufacturing property is provided over the estimated useful lives of the assets using a straight-line basis. The composite depreciation rate was 7.33% for 1986 (8.90% — 1985).

1. Summary Of Significant Accounting Policies *(continued)*

(e) **Investment In Telesat Canada**

The investment in 330,000 common shares of Telesat Canada, representing 5.5% of the total outstanding shares, is recorded at original cost. There is no quoted market value for this investment, however, its estimated book value was $9,000,000 as at December 31, 1986 ($8,000,000 — 1985).

(f) **Income Taxes**

The Company and its subsidiaries use the deferral method of income tax allocation by providing deferred income taxes on all timing differences between accounting income and taxable income except for allowance for funds used during construction where no deferred tax is provided *(Note 6)*.

(g) **Translation Of Foreign Currencies**

Trade transactions completed in foreign currencies are reflected in Canadian dollars at the rates prevailing at the time of the transactions. Debt payable in U.S. funds is reflected in the financial statements at the Canadian dollar equivalent at the rate of exchange prevailing at the balance sheet date.

Currency gains and losses are included in net earnings for the year except for gains and losses on long-term debt which are amortized over the remaining periods to maturity of the related issues *(Note 5)*.

The Company's total foreign currency indebtedness as at December 31, 1986 was $67,000,000 U.S. ($75,700,000 U.S. — 1985). During 1986, the Company entered into an agreement to purchase in 1991, $25,000,000 U.S. at a fixed Canadian dollar exchange rate.

(h) **Research And Development**

Product development expenditures which in management's opinion result in identifiable telecommunications operations assets have been deferred. Such deferred expenditures amounted to $5,900,000 at December 31, 1986 ($5,400,000 — 1985) and will be amortized over a period not to exceed the expected life of the related products.

All other expenditures for research, development and improvement of new and existing products and services are expensed as incurred. The amount expensed in 1986 was $22,500,000 ($17,300,000 — 1985).

(i) **Leases**

Leases are classified as capital or operating depending upon the terms of the contracts.

Where the Company is the lessee, asset values recorded under capital leases are amortized on a straight-line basis over the life of the lease. Obligations recorded under capital leases are reduced by rental payments net of imputed interest. Where the Company is the lessor, it acts as a financing intermediary. Finance income derived from these financing leases is recorded so as to produce a constant rate of return over the terms of the leases.

Long-term lease rental agreements on equipment leased to customers are accounted for as operating leases. Rental income is recognized as service revenue over the term of the lease, generally five or ten years. The equipment is depreciated in accordance with existing depreciation policy.

2. Operating Revenues – Telecommunications Operations

	1986	1985
	($ Millions)	
Local service	**$ 477.4**	$ 459.0
Long distance service	**772.5**	705.7
Other	**73.7**	68.1
	1,323.6	1,232.8
Less — uncollectible operating revenues	**15.6**	15.8
	$1,308.0	$1,217.0

3. Operating Expenses – Telecommunications Operations

	1986	1985
	($ Millions)	
Operations	**$ 600.5**	$ 569.3
Depreciation	**266.9**	250.6
Provincial, municipal and other taxes	**54.9**	56.1
	$ 922.3	$ 876.0

4. Other Income – Net – Manufacturing Operations

In 1985 other income of $10.8 million is the net of non-recurring income and expense items. Included are the withdrawal of surplus pension plan contributions ($22.7 million) and a gain on disposal of property ($3.2 million) netted against non-recurring costs ($15.1 million) relating to downsizing and relocation activities.

5. Debt Service Costs – Net

	1986	1985
	($ Millions)	
Interest on long-term debt	**$ 124.9**	$ 118.8
Other interest	**3.8**	9.6
Amortization of unrealized deferred losses on foreign exchange	**5.9**	4.8
Amortization of issue costs	**1.4**	1.3
	136.0	134.5
Less — Allowance for funds used during construction	**13.5**	13.7
— Service charges on overdue accounts	**5.2**	4.5
	$ 117.3	$ 116.3

6. Income Taxes

	1986	1985
	($ Millions)	
Current — Federal	**$ 92.1**	$ 72.7
— Provincial	**39.1**	30.1
Deferred	**11.0**	6.3
	$ 142.2	$ 109.1

A reconciliation of the Canadian statutory income tax rate to the effective income tax rate is as follows:

	1986	1985
Combined basic federal and provincial income tax rate	**53.8%**	52.9%
Allowance for funds used during construction	**(1.9)**	(3.2)
Other	**.2**	(1.2)
Effective income tax rate per Consolidated Statement of Earnings	**52.1%**	48.5%

7. Inventories – Manufacturing Operations

Inventories are valued at the lower of cost and net realizable value:

	1986	1985
	($ Millions)	
Finished goods	$ 8.5	$ 10.7
Work in process	12.2	9.5
Raw materials and other	17.2	21.1
	$ 37.9	$ 41.3

8. Equity

(a) **Details Of Shareholders' Equity**

	Redemption Premium (Note 8e)	1986	1985
		($ Millions)	
Ordinary			
Ordinary Shares without par value: 48,059,623 shares outstanding (44,604,381 — 1985)		$ 678.2	$ 585.4
Retained earnings		289.4	256.1
Contributed surplus		3.9	3.8
		971.5	845.3
Preference And Preferred			
$2.32 Cumulative Redeemable Convertible Subordinate Preferred Shares Par Value of $25 Each		—	.6
Cumulative Preference And Preferred Shares			
Par Value of $100 Each			
6% Preference	10.0%	1.0	1.0
4⅜% Preferred	4.0%	6.0	6.0
4½% Preferred	4.0%	5.0	5.0
4¾% Preferred	5.0%	7.5	7.5
4¾% Preferred (Series 1956)	4.0%	7.5	7.5
5.15% Preferred	5.0%	12.0	12.0
5¾% Preferred	4.0%	10.0	10.0
6% Preferred	5.0%	4.5	4.5
Par Value of $25 Each			
4.84% Preferred	4.0%	20.0	20.0
6.80% Preferred	6.0%	10.0	10.0
7% Preferred	—	—	20.0
7.04% Preferred	5.75%	20.0	20.0
7.40% Preferred	3.0%	39.5	41.0
7.65% Preferred	2.0%	26.4	27.0
11.24% Preferred	5.0%	50.0	50.0
		219.4	242.1
Total Equity		**$1,190.9**	$1,087.4

(b) **Authorized Capital**

The Company is permitted, subject to directors' and shareholders' approval, to issue shares with or without par value up to the nominal amount of $1,250,000,000. As at December 31, 1986 the total authorized share capital of the Company was $1,000,000,000 ($1,000,000,000 — 1985).

8. Equity *(continued)*

(c) **Changes During 1986**

Ordinary shares

— 2,950,000 shares were issued in June 1986 for $80,388,000 (nil — 1985).

— 41,520 shares were issued during 1986 on conversion of 20,760 — $2.32 convertible subordinate preferred shares (5,454 on conversion of 2,727 shares — 1985).

— 460,128 shares (591,174 — 1985) were issued during 1986 for $11,778,000 ($12,937,000 — 1985) through the Dividend Reinvestment and Share Purchase Plan.

— 3,594 shares were issued during 1986 through the Employee Share Purchase Plan at a price of $22.73 per share (319,133 shares at a price of $17.79 per share — 1985).

Preferred shares

— the Company redeemed 800,000 — 7% preferred shares in 1986 (100,000 — 1985) in the amount of $20,000,000 ($2,500,000 — 1985).

— the Company redeemed 60,000 — 7.40% preferred shares in 1986 (30,000 — 1985) in the amount of $1,500,000 ($750,000 — 1985).

— the Company redeemed 20,100 — 7.65% preferred shares in 1986 (40,200 — 1985) in the amount of $503,000 ($1,005,000 — 1985). The Company had redeemed an additional 20,100 shares in 1985 in the amount of $503,000 to reduce its 1986 purchase obligations.

— the Company redeemed 3,411 — $2.32 convertible subordinate preferred shares in 1986 (nil — 1985) in the amount of $85,000 (nil — 1985) and the remainder were converted into ordinary shares.

(d) **Ordinary Shares Reserved**

At December 31, 1986 the following shares remained reserved:

— 1,321,805 shares under the Company's Employee Share Purchase Plan (ESPP) and the Long-Term Incentive Share Option Plan (LISOP). The purchase price per share under the ESPP will be the lower of $22.725 or 90% of the average market price on the last day of the purchase period February 27, 1987, but not less than fully diluted book value of $18.95 at the commencement of the purchase period.
During 1986, options to purchase 69,900 ordinary shares were issued to key Company employees under the terms of the LISOP. The options permit the purchase of shares during the period February 19, 1987 to February 19, 1991 at a price of $25.75 per share.

— 1,145,016 shares for issuance under the Dividend Reinvestment and Share Purchase Plan as approved by the CRTC on October 28, 1982. The purchase price for the plan is based on the average market price for the five days preceding the investment date.

(e) **Preferred Share Redemption Requirements And Purchase Obligations**

Redemption requirements or purchase obligations apply to three issues:

— 7.40% preferred shares are subject to a purchase obligation requiring the Company to make all reasonable efforts to purchase in each 12 month period 60,000 shares at a price not exceeding $25 per share excluding costs of purchase.

— 7.65% preferred shares are subject to a purchase obligation requiring the Company to make all reasonable efforts to purchase in each 12 month period 40,200 shares at a price not exceeding $25 per share excluding costs of purchase.

— 11.24% preferred shares are subject to (a) a purchase obligation requiring the Company to make all reasonable efforts to purchase in each 3 month period 15,000 shares at a price not exceeding $25 per share excluding costs of purchase and (b) a requirement on the part of the Company to redeem on June 15, 1990 any shares tendered on or before May 15, 1990 at a price of $25 per share. Commencing July 1, 1990 and thereafter, the Company shall make all reasonable efforts to purchase 4% per annum of the shares outstanding immediately after the June 15, 1990 redemption at a price not exceeding $25 per share excluding costs of purchase.

Other issues are redeemable at the stated redemption premium at the Company's option.

9. Long-Term Debt

(a) **Details Of Long-Term Debt**

	1986	1985
	($ Millions)	
British Columbia Telephone Company First Mortgage Bonds		
Series J 5¾% due July 15, 1986	$ —	$ 20.0
Series K 5⅝% due April 15, 1988	20.0	20.0
Series L 6¾% due October 15, 1989	30.0	30.0
Series M 6⅜% due March 15, 1991	30.0	30.0
Series N 9⅛% due April 1, 1990	3.3	3.3
Series O 9⅝% due November 15, 1992	18.0	18.0
Series P 9⅛% due November 15, 1992	.5	.5
Series Q 8¼% due March 1, 1994	35.0	35.0
Series S 7⅞% due November 15, 1995	25.0	25.0
Series T 8⅝% due October 15, 1993	40.0	40.0
Series U 8⅛% due November 1, 1996 ($20,000,000 U.S.)	27.6	28.0
Series V 9% due October 1, 1997	40.0	40.0
Series X 9¼% due April 15, 1998	35.0	35.0
Series Y 11% due January 15, 1996	45.0	45.0
Series AA 10¼% due April 1, 1995	30.0	30.0
Series AC 10½% due February 1, 1982-96 ($21,500,000 U.S.)	29.6	32.4
Series AD 10¼% due October 15, 2001	60.0	60.0
Series AE 9.70% due June 15, 1999	50.0	50.0
Series AF 9⅞% due November 1, 2003	75.0	75.0
Series AG 14¼% due April 1, 1991	74.2	75.0
Series AH 16⅜% due April 1, 1992	99.0	100.0
Series AI 17¼% due September 1, 1988	50.0	50.0
Series AK 12¼% due February 15, 1999	70.0	70.0
Series AL 11.35% due November 15, 2005	125.0	125.0
	1,012.2	1,037.2
Mortgage payable		
Issued at 12½% due April 30, 1989	11.6	11.6
Promissory notes and bank loans		
Amount reclassified *(Note 10)*	30.9	23.0
Issued at varying rates of interest from 8.70% to 15.40% and maturing on varying dates from 1987 to 1991	23.9	15.2
	66.4	49.8
Microtel Limited		
Interest-rate conversion and credit agreements with effective fixed rates of interest		
— 10.81% due 1988	10.0	—
— 12.1% due 1990	20.0	20.0
— 10.98% due 1992	10.0	3.8
Other at varying rates of interest from 6.0% to 8.25%	.3	.4
	40.3	24.2
Amounts due under capitalized leases	23.7	19.0
Total Long-Term Debt	1,142.6	1,130.2
Less – Current maturities *(Note 10)*	23.8	28.9
Long-Term Debt	**$1,118.8**	**$1,101.3**

9. Long-Term Debt *(continued)*

(b) **First Mortgage Bond Issue Requirements**

The Company's telecommunications property is subject to liens under the Deed of Trust and Mortgage under which the First Mortgage Bonds are issued. The Deed of Trust and Mortgage requires either an annual sinking fund payment of 1% of the principal amount of bonds outstanding or the pledge of additional unmortgaged property in the amount of 1½% of the principal. In 1986, sinking fund payments were made in respect of the Series AG and AH First Mortgage Bonds and additional unmortgaged property was pledged in respect of all other outstanding bonds. Additional First Mortgage Bond issues also must meet the interest coverage ratio standards specified under the Deed of Trust and Mortgage.

(c) **Redemption/Retraction Provisions**

The First Mortgage Bonds, except for Series AG and AH, may be redeemed at the option of the Company prior to maturity at various premiums to a maximum of 10.65%. Such redemptions, except for Series AC, AI and AK as noted below, cannot be made if the funds borrowed for refunding purposes have an interest cost that is less than the interest cost of the bonds redeemed.

The Series AC Bonds are redeemable at the option of the Company on and after March 1, 1986 at a premium of 4.95%.

The Series AI Bonds are redeemable at the option of the Company on and after September 1, 1987 at a premium of ½%.

The Series AK Bonds are retractable at the option of the holder on February 15, 1989 and 1994, at which dates the Company has the option to set a new rate of interest or to redeem the bonds.

(d) **Long-Term Debt Maturities**

The Series AC Bonds mature serially in the amount of $1,710,000 U.S. on February 1, in each of the years 1982 to 1995 and the remaining $6,060,000 U.S. matures on February 1, 1996.

A total of $91,416,000 of the Series AH Bonds has been extended for a further five year term maturing April 1, 1992.

The total long-term debt maturities during each of the next five years are:

	($ Millions)
1987	$ 16.3
1988	$ 89.8
1989 *(Excluding Series AK)*	$ 50.5
1990	$ 30.3
1991	$108.2

(e) **Promissory Notes**

The promissory notes are issued to obtain funds for general corporate purposes including the cost of extension and improvements to the plant and properties of the Company.

These borrowings will be repaid from the proceeds of long-term financings.

The Company has long-term agreements for revolving loan facilities and at December 31, 1986, the agreements totalled $130,000,000 ($172,000,000 — 1985). Drawdowns under the agreements are by way of promissory notes issued at either fixed or floating interest rates for periods of up to five years. Short-term obligations *(Note 10)* have been reduced by $30,900,000 ($23,000,000 — 1985) to reflect these arrangements.

10. Short-Term Obligations

Amounts falling due for redemption within one year including short-term indebtedness pending permanent financing are as follows:

	1986	1985
	($ Millions)	
Bank loans, 9.75% interest	**20.6**	7.4
Bank loans ($6,521,000 U.S.), 6.53% to 8.00% interest	**9.0**	35.3
Promissory notes, current maturities, 5.80% to 12.75% interest	**28.2**	36.6
	57.8	79.3
Less: Amount reclassified as long-term debt *(Note 9)*	**30.9**	23.0
	26.9	56.3
First Mortgage Bonds, current maturities *(Note 9)*		
Series J 5¾%	**$ —**	$ 20.0
Series AC 10½% ($3,420,000 U.S.)	**4.7**	2.4
Series AH 16⅜%	**7.6**	—
Current maturities of long-term debt of subsidiaries	**4.0**	.1
Amounts due under capitalized equipment leases	**7.5**	6.4
	23.8	28.9
Amounts held under Employee Share Purchase Plan and Dividend Reinvestment Plan	**9.5**	.1
	60.2	85.3
Less: Temporary cash investment to be applied to maturing promissory notes	**23.7**	49.1
	$ 36.5	$ 36.2

Short-term obligations are included in total capitalization for regulatory purposes in computing capitalization ratios and rates of return on capital.

11. Lines Of Credit

At December 31, 1986, the Company had in place aggregate lines of credit totalling $503,700,000 ($481,200,000 — 1985). The Company maintains unused lines of credit with chartered banks at least equivalent to the aggregate of promissory notes outstanding.

12. Working Capital

	1986	1985
	($ Millions)	
(Increase) decrease in current assets:		
Accounts receivable	**$(16.7)**	$(21.9)
Inventories	**3.4**	18.2
Prepaid expenses	**(1.2)**	11.9
Increase (decrease) in current liabilities:		
Accounts payable and accrued liabilities	**(29.3)**	18.7
Income taxes payable	**.2**	39.3
Other non-cash current liabilities	**11.6**	(3.3)
(Increase) decrease in non-cash working capital	**(32.0)**	62.9
(Increase) decrease in cash working capital	**(16.2)**	(9.3)
Working capital deficiency:		
— beginning of year	**96.0**	42.4
— end of year	**$ 47.8**	$ 96.0

13. Commitments And Contingent Liabilities

(a) The Company estimates Telecommunications construction programs for additional plant and facilities to cost $331,300,000 in 1987. Substantial purchase commitments have been made in connection with these programs.

(b) The Company was reassessed by Revenue Canada for the years 1979 and 1980. The notices of reassessment deny certain Scientific Research claims by the Company and require payment of additional income taxes and interest totalling $1,500,000 for those years. If the years subsequent to 1980 had been included in the reassessment, the additional tax and interest would cause retained earnings to be reduced by a further $11,600,000.

In the opinion of tax counsel, the Company has a strong basis to reverse the 1979 and 1980 reassessments and it is therefore treating the $1,500,000 as recoverable in the consolidated Balance Sheet at December 31, 1986. Consequently, no provision has been made in the Company's accounts at December 31, 1986 for any additional taxes relative to Scientific Research subsequent to 1980.

(c) The Company has provided guarantees regarding the supply of equipment for the North Warning System project by its subsidiary company, Microtel. The guarantees provide for the full performance and fulfillment of all obligations arising from the contract.

(d) The Company occupies leased premises in various centres across Canada and has land and equipment under operating leases expiring in periods from one to eighty-four years. Future minimum lease payments are:

	($Millions)
1987	$11.9
1988	$ 8.3
1989	$ 6.2
1990	$ 4.8
1991	$ 2.9

(e) See also *Note 9* and *Note 14*.

14. Pension Plans

The Company and the Union maintain pension plans covering all regular full-time employees in both Telecommunications and Manufacturing Operations.

The Union sponsored pension plans for bargaining unit employees in Telecommunications Operations require the Company to contribute a fixed percentage of employee gross earnings to trust funds.

Actuarial studies are prepared for Company sponsored plans at least every three years and the Company pays into trust funds the annual accrued pension costs as determined by the actuary. Experience gains from the Company sponsored plans in Manufacturing and Telecommunications are used to eliminate current service costs. Shortfalls, if any, due to variations from expectation, obligations arising from plan amendments and changes in actuarial assumptions, are funded and amortized over periods not exceeding 15 years as recommended by the actuary.

The Pension Benefits Standards Act, which became effective on January 1, 1987 and the recommendations of the Canadian Institute of Chartered Accountants, will have an effect on the Company sponsored pension plans. The Company will implement these changes in 1987.

Based on the latest actuarial reports of the Company sponsored pension plans, which used an estimate of the accrued pension obligations and market related value for assets valuation, a comparison of the plan assets and plan obligations is as follows:

	1986	1985
	($ Millions)	
Actuarial value of assets	**$ 406.6**	$ 343.9
Actuarial value of obligations	**405.2**	347.0
Net surplus (unfunded liability)	**$ 1.4**	$ (3.1)

The above surplus (unfunded liability) is net of surplus funds in the amount of $17,500,000 ($15,300,000 — 1985).

The total pension contribution amounted to $32,900,000 in 1986 ($7,300,000 in 1985 after withdrawal of $22,700,000 surplus contributions from its pension plans by the Manufacturing Operation).

15. Related Party Transactions

Transactions with related parties (all affiliates of GTE Corporation) for the year ended December 31, 1986 were purchases and sales of telecommunications equipment and supplies *(Note 1)*, directory advertising commissions, royalties on equipment manufactured under licence and payments for services rendered under cost-sharing agreements. Approximately 52% (61% — 1985) of the sales and 12% (16% — 1985) of the purchases of Microtel were to and from related parties. Such sales include $67,900,000 to the Company in 1986 ($75,800,000 — 1985). Microtel sales of telecommunications equipment to the Company are at prices and terms as low as those offered to Microtel's most favoured customers for like materials and services under comparable conditions.

In 1985, a joint venture involving the Company's management pension fund and a property development and construction company acquired a 10-acre office and manufacturing site from the Company's subsidiary, Microtel, for $6,000,000.

16. Industry Segments Information

British Columbia Telephone Company and its subsidiary companies operate principally in two business segments:

1. Telecommunications operations, which include local exchange and long distance telephone services, transmission of facsimile and data, lease financing, other telecommunications services and sales; and
2. Telecommunications equipment manufacturing, which includes research and development and sales of telecommunications equipment, training, engineering, installation services and distributed products.

The following table sets forth revenues, operating profits and supplementary data for the years ended December 31, 1986 and 1985 for each of the Company's business segments:

	Telecommunications Operations		Manufacturing Operations		Consolidated Operations	
	1986	1985	**1986**	1985	**1986**	1985
			($ Millions)			
Sales to customers	**$1,308.0**	$1,217.0	**$102.8**	$ 91.7	**$1,410.8**	$1,308.7
Inter-segment sales	**—**	—	**67.9**	75.8	**67.9**	75.8
Total revenues	**1,308.0**	1,217.0	**170.7**	167.5	**1,478.7**	1,384.5
Segment operating profit	**385.7**	341.0	**4.3**	.3	**390.0**	34 .3
Interest charges	**(113.5)**	(109.9)	**(3.8)**	(6.4)	**(117.3)**	(116.3)
Income taxes	**(141.7)**	(113.3)	**(.5)**	4.2	**(142.2)**	(109.1)
Net earnings (loss)	**$ 130.5**	$ 117.8	**$ —**	$ (1.9)	**$ 130.5**	$ 115.9
Identifiable assets	**$2,982.4**	$2,892.9	**$132.9**	$126.1	**$3,115.3**	$3,019.0
Capital expenditures	**$ 346.4**	$ 359.1	**$ 14.5**	$ 9.4	**$ 360.9**	$ 368.5
Depreciation and amortization	**$ 266.9**	$ 250.6	**$ 6.9**	$ 7.1	**$ 273.8**	$ 257.7

Telecommunications operations are conducted in the Province of British Columbia. Manufacturing operations have plants located in the Provinces of British Columbia and Ontario. Export market sales were 35.1% of manufacturing sales to the public in 1986 (30.7% – 1985).

17. Prior Year Presentation

The 1985 amounts have been reclassified, where applicable, to conform with the 1986 presentation.

Financial Supplement

Financial Supplement

Quarterly Financial Data

Three Months Ended	March 31	June 30	Sept. 30	Dec. 31	Total 1986
		($ Millions)			
Telecommunications Operations					
Operating revenues	$312.9	$324.3	$333.3	$337.5	$1,308.0
Operating expenses	227.3	230.9	235.1	229.0	922.3
Telecommunications operating earnings	85.6	93.4	98.2	108.5	385.7
Manufacturing Operations					
Sales	39.9	34.9	30.2	65.7	170.7
Costs and expenses	37.2	35.6	36.9	56.7	166.4
Manufacturing operating earnings (loss)	2.7	(.7)	(6.7)	9.0	4.3
Combined Operating Earnings	88.3	92.7	91.5	117.5	390.0
Debt service costs	29.2	30.6	24.4	33.1	117.3
Earnings before income taxes	59.1	62.1	67.1	84.4	272.7
Income taxes	30.4	31.9	34.7	45.2	142.2
Net earnings	28.7	30.2	32.4	39.2	130.5
Less — Preference and preferred share dividends	4.3	4.1	4.1	4.1	16.6
Ordinary Share Earnings	$ 24.4	$ 26.1	$ 28.3	$ 35.1	$ 113.9
Earnings Per Ordinary Share	$ .54	$ .59	$ .60	$ .73	$ 2.46
Average Ordinary Shares Outstanding *(Thousands)*	44,710	44,827	47,464	48,051	46,263

Current Cost Reporting

In December 1982, the Accounting Standards Committee of the Canadian Institute of Chartered Accountants (CICA) issued a recommendation, Section 4510 "Reporting the Effects of Changing Prices", that major Canadian corporations disclose current cost information as supplementary financial information in their 1983 and subsequent annual reports on an experimental basis.

The committee felt that during prolonged periods of significant inflation, there was a need for information about the impact of changing prices on the financial position and operating results of an enterprise.

In its Annual Reports, 1983 to 1985, the Company has provided unaudited Current Cost information under the Financial Supplement section pursuant to the CICA recommendation. In order to provide such information many subjective assumptions have to be made. A survey of report users indicated that this information was seldom used. Furthermore, being a regulated utility, the Company's rate of return and revenues are based on historical costs rather than on current costs.

For these reasons, the Company has decided to discontinue Current Cost Reporting in the Annual Report.

Employee Costs

	Telecommunications[Note]		Manufacturing		Consolidated	
	1986	1985	**1986**	1985	**1986**	1985
			($ Millions)			
Total Employee Costs Analyzed As Follows:	**$560.0**	$532.1	**$ 85.8**	$ 68.5	**$645.8**	$600.6
Salaries And Wages As Payment For:						
Time on the job	**$390.5**	$377.6	**$ 66.7**	$ 74.4	**$457.2**	$452.0
Vacations and holidays	**77.8**	72.1	**10.9**	8.5	**88.7**	80.6
Education Centre training	**8.8**	5.9	**.1**	.3	**8.9**	6.2
Other	**12.8**	11.5	**1.1**	2.2	**13.9**	13.7
	99.4	89.5	**12.1**	11.0	**111.5**	100.5
Total Salaries And Wages	**489.9**	467.1	**78.8**	85.4	**568.7**	552.5
Related Costs:						
Company funding to pension plans	**32.2**	30.0	**.7**	(22.7)	**32.9**	7.3
Group medical/ dental benefit payments	**10.7**	9.9	**2.1**	2.1	**12.8**	12.0
Other employee benefits	**9.0**	8.8	**1.2**	.8	**10.2**	9.6
Canada Pension Plan/Quebec Pension Plan	**5.9**	5.4	**.9**	.9	**6.8**	6.3
Unemployment Insurance	**11.0**	9.8	**1.6**	1.6	**12.6**	11.4
Workers' Compensation	**1.3**	1.1	**.5**	.4	**1.8**	1.5
Total Related Costs	**70.1**	65.0	**7.0**	(16.9)	**77.1**	48.1
Total	**$560.0**	$532.1	**$ 85.8**	$ 68.5	**$645.8**	$600.6

Taxes Levied By Governments In Canada

	1986	1985
	($ Millions)	
Income taxes		
Federal	**$ 99.8**	$ 77.1
Provincial	**42.4**	32.0
Property and machinery taxes	**39.6**	42.2
Capital taxes	**3.3**	3.2
Payroll taxes[Note]	**21.2**	19.3
	$206.3	$173.8

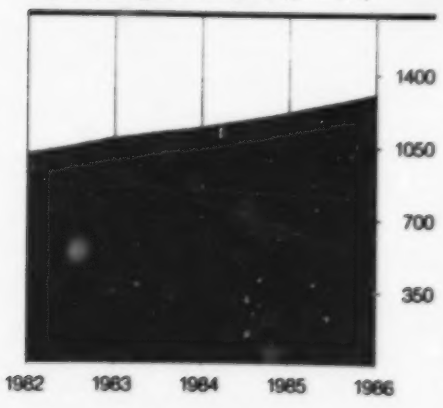
NOTE: Includes amounts capitalized

Consolidated Five-Year Statistics

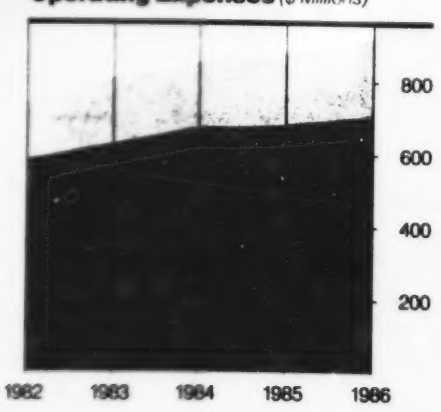
Selected Income Items *($ Millions)*	
Telecommunications operating revenues	
Telecommunications operating expenses	
Salaries and wages expense	
Provincial, municipal and other taxes	
Other operating expense	
Depreciation	
Manufacturing sales	
Manufacturing cost of sales	
Manufacturing selling and administrative expenses *(Note)*	
Combined operating earnings	
Debt service costs	
Income taxes	
Preference and preferred dividends	
Ordinary share earnings	
Ordinary share dividends	
Financial Ratios	
Earnings per ordinary share	
Dividends declared per ordinary share	
Equity per ordinary share	
Return on average ordinary share equity	
Return on average invested capital	
Ratio of debt to total capitalization	

NOTE: 1985 includes Other income — net, $10.8 million.

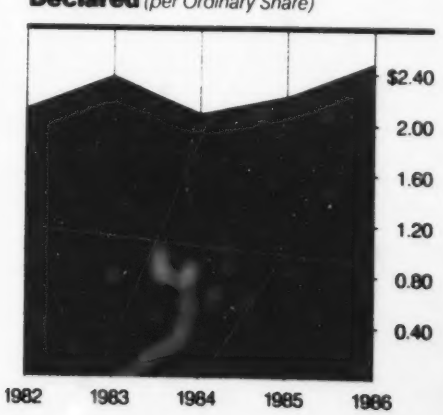
Telecommunications Operating Revenues *($ Millions)*



Telecommunications Operating Expenses *($ Millions)*

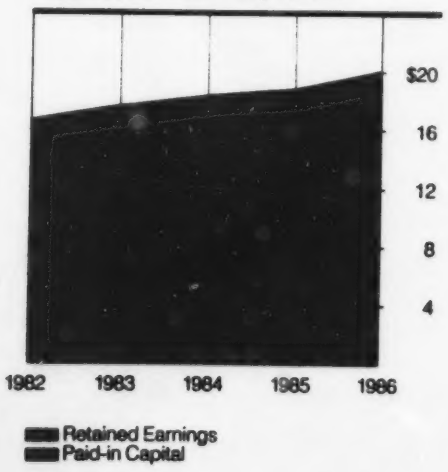


Earnings and Dividends Declared *(per Ordinary Share)*



1986	1985	1984	1983	1982
$1,308.0	$1,217.0	$1,147.8	$1,091.3	$1,009.4
922.3	876.0	851.3	806.4	741.3
384.5	371.3	380.0	349.1	331.3
54.9	56.1	59.8	57.0	50.4
216.0	198.0	179.0	179.2	157.8
266.9	250.6	232.5	221.1	201.8
170.7	167.5	170.4	206.5	243.6
136.6	148.2	146.0	170.7	209.5
29.8	19.0	28.6	23.7	21.8
390.0	341.3	292.3	297.0	280.4
117.3	116.3	107.4	96.0	107.8
142.2	109.1	82.4	93.9	83.7
16.6	18.4	20.4	20.9	16.7
113.9	97.5	82.1	86.2	72.2
79.8	76.1	66.1	58.0	54.8
$ 2.46	$ 2.21	$ 2.07	$ 2.36	$ 2.11
$ 1.72	$ 1.72	$ 1.66	$ 1.60	$ 1.60
$ 20.21	$ 18.95	$ 18.43	$ 17.78	$ 16.83
12.65%	12.01%	11.52%	13.77%	12.81%
11.24%	10.86%	10.68%	11.18%	11.05%
49%	51%	52%	54%	56%

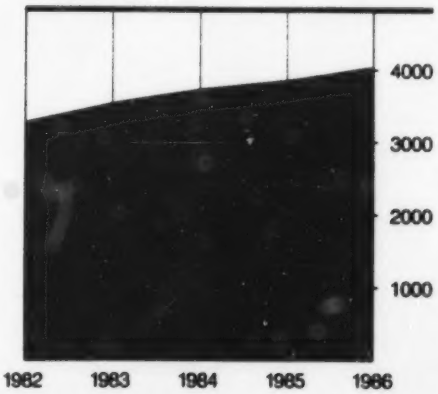
Equity per Ordinary Share



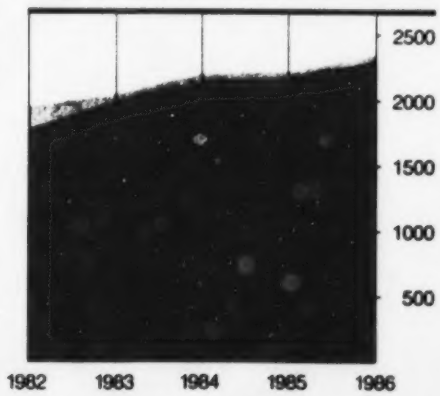
Consolidated Five-Year Statistics

Selected Balance Sheet Items *($ Millions)*	
	Total property, at cost
	Accumulated depreciation
	Total capitalization
	Short-term obligations
	Long-term debt
	Preference and preferred shares
	Ordinary share equity
Telecommunications Statistics	
	Gross capital expenditures *($ Millions)*
	Customer access lines in service *(Thousands)*
	Percent electronic switched customer lines
	Net property investment per customer access line *($)*
	Local calls completed *(Millions)*
	Long distance calls completed *(Millions)*
	Regular full time employees at year end
	Number of shareholders at year end
Manufacturing Statistics	
	Domestic sales *($ Millions)*
	Export sales *($ Millions)*
	Gross research and development expenditures *($ Millions)*
	Regular full time employees at year end
	Microtel Limited
	Microtel Pacific Research Limited

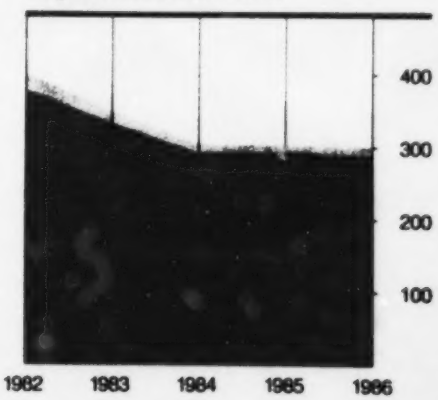
Property Investment *($ Millions)*



Capital Structure *($ Millions)*

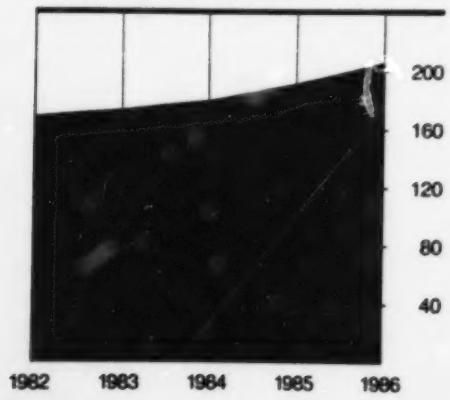


Telecommunications Capital Expenditures *($ Millions)*



1986	1985	1984	1983	1982
$4,040.8	$3,856.7	$3,716.6	$3,529.0	$3,255.5
1,227.0	1,168.9	1,131.4	1,041.2	907.9
2,346.2	2,224.9	2,213.7	2,059.2	1,952.8
36.5	36.2	49.7	47.1	170.4
1,118.8	1,101.3	1,096.5	1,060.5	924.0
219.4	242.1	262.9	272.7	280.7
971.5	845.3	805.1	678.9	577.7
$ 346.4	$ 359.1	$ 338.9	$ 371.8	$ 424.8
1,579	1,525	1,475	1,441	1,400
87.3%	69.7%	50.5%	40.5%	39.9%
$ 1,719	$ 1,734	$ 1,723	$ 1,701	$ 1,652
4,139.7	3,718.8	3,639.6	3,229.2	3,140.0
207.1	192.2	180.2	173.5	168.4
13,361	13,634	13,973	14,311	14,926
28,192	30,009	32,045	29,949	27,692
$ 134.6	$ 139.4	$ 142.8	$ 181.4	$ 208.8
$ 36.1	$ 28.1	$ 27.6	$ 25.1	$ 34.8
$ 27.4	$ 26.1	$ 23.6	$ 15.4	$ 13.8
1,873	1,925	2,284	2,187	2,638
351	304	319	297	278

Long Distance Calls *(Millions)*



Getting the money in... Customer remittances are recorded in the centralized customer payment section.

Shareholder Information

		1986	1985
	Number of ordinary shareholders	**16,992**	17,719
	Number of shares outstanding at December 31	**48,059,623**	44,604,381
	Volume of shares traded	**7,140,751**	7,999,388
	The Toronto Stock Exchange Price Range (High-Low)	**$29¼-24½**	$27⅛-21¼

Principal Ownership

The Company's outstanding ordinary shares totalled 48,059,623 as at December 31, 1986.

Anglo-Canadian Telephone Company of Montreal (a wholly-owned subsidiary of GTE Corporation), was at December 31, 1986 the owner of 24,066,272 shares, or 50.08% of the total ordinary shares outstanding.

Dividend Reinvestment And Share Purchase Plan

The Company maintains a plan whereby holders of all classes of shares can elect to acquire ordinary shares through automatic reinvestment of dividends and investment of optional contributions. The Plan provides a discount of 5% on the price of ordinary shares purchased with reinvested ordinary share dividends and allows for optional contributions of up to $5,000 per calendar quarter for the purchase of additional ordinary shares. For an Offering Circular explaining the Plan, please write to: Investor Relations, 19th Floor, 3777 Kingsway, Burnaby, B.C. V5H 3Z7. Residents in the Vancouver area may also call 432-2413, while residents elsewhere in Canada may call free of charge 1-800-663-9405.

Ordinary Share Dividends

Dividends are payable quarterly on the first day of January, April, July and October. In 1986, dividends declared amounted to $.43 per share for each quarter, for an annual total of $1.72.

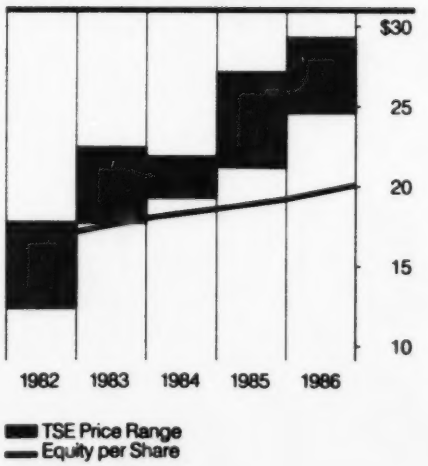
Market Trading

Shares are listed for trading on the Toronto, Montreal and Vancouver Stock Exchanges.

Transfer Agent And Registrar

Montreal Trust Company

Equity per Ordinary Share and Market Trading Range



Federal Government Valuation Day Value (December 22, 1971) **$12.75/Share**

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Directors

(a) **Gordon F. MacFarlane**
Chairman and
Chief Executive Officer
British Columbia Telephone Company
Burnaby, B.C.

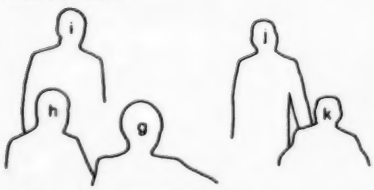
(b) **Barbara J. Rae**[1]
President
Office Assistance (Canada) Ltd.
Vancouver, B.C.

(c) **James L. Johnson**[2]
President & Chief Operating Officer
GTE Corporation
Stamford, Connecticut

(d) **W. Robert Wyman**[2]
Chairman
Pemberton Houston Willoughby Bell
Gouinlock Inc.
Vancouver, B.C.

(e) **Gerald H. D. Hobbs**[3]
Private Investor
Vancouver, B.C.

(f) **Justin V. Harbord**[1]
Company Director
Victoria, B.C.



(g) **M. Rendina K. Hamilton**[3]
Barrister and Solicitor
Kelowna, B.C.

(h) **John W. Pitts**[1]
President and Chief Executive Officer
MacDonald, Dettwiler and Associates Ltd.
Richmond, B.C.

(i) **Victor F. MacLean**[3]
Company Director
Vancouver, B.C.

(j) **Allan L. Rayfield**
Senior Vice-President,
GTE Corporation and
President,
GTE Products and Systems,
GTE Service Corporation
Stamford, Connecticut

(k) **Horace B. Simpson**[3]
Director
Okanagan Skeena Group Ltd.
Kelowna, B.C.

Member of:
1. Audit Committee
2. Salary Committee
3. Pension Trust Committee

Officers

Gordon F. MacFarlane
Chairman and Chief Executive Officer

(a) **Terence F. Heenan**
President and Chief Operating Officer

(b) **Betty J. Rumford**
Assistant Secretary

(c) **Colin Q. Patterson**
Vice-President
Corporate Development

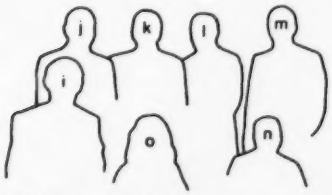
(d) **Leo J. Dooling**
Vice-President
Revenue Requirements & Comptroller

(e) **J. Neil Stewart**
Treasurer

(f) **Brian A. Canfield**
Vice-President
Technical Support

(g) **Roy A. Osing**
Vice-President
Network Marketing

(h) **W. K. (Bill) McCourt**
Vice-President and
Area General Manager — Burrard



(i) **D. Barry McNeil**
Vice-President
Corporate Finance

(j) **Robert H. Stevens**
Vice-President
Supply, Transportation and Buildings

(k) **E. Lynn Patterson**
Vice-President
Business Telecom Equipment

(l) **James A. MacInnes**
Vice-President
Corporate Communications

(m) **Donald W. Champion**
Vice-President
Administration

(n) **K. Donald A. Morrison**
Vice-President
General Counsel and Secretary

(o) **Jocelyne M. Côté-O'Hara**
Vice-President
Government Relations

British Columbia Telephone Company
Ninety-Fifth Annual Report 1986

Incorporated by Special Act of the Parliament of Canada, April 12, 1916

Head Office
3777 Kingsway
Burnaby, B.C.
V5H 3Z7

Duplicate Annual Reports
Every effort has been made to eliminate duplications in our shareholders' mailing list. However, if you have more than one holding you will receive a separate report for each registration unless your shares are registered under exactly the same name.

Annual Meeting
The Annual General Meeting of the Shareholders will be held on Thursday, March 19, 1987 at 10:00 a.m. in the Auditorium of the British Columbia Telephone Company Building, 3777 Kingsway, Burnaby, B.C., Canada.

Additional information or copies of the Annual Report may be obtained by writing to Investor Relations at the Head Office address above. Residents in the Vancouver area may also call 432-4410, while residents elsewhere in Canada may call free of charge 1-800-663-9405.